THE OTTAWA SUMMIT AND U.S. INTERNATIONAL ECONOMIC POLICY

HEARINGS

BEFORE THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

NINETY-SEVENTH CONGRESS

FIRST SESSION

JULY 14 AND 16, 1981

Printed for the use of the Joint Economic Committee

U.S. GOVERNMENT PRINTING OFFICE

86-005 O WASHINGTON : 1982

For sale by the Superintendent of Documents, U.S. Government Printing Office
Washington, D.C. 20402

J841-6

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CONTENTS

WITNESSES AND STATEMENTS

TUESDAY, JULY 14, 1981

	Page
Reuss, Hon. Henry S., chairman of the Joint Economic Committee: Opening statement	1
Rashish, Hon. Myer, Under Secretary for Economic Affairs, Department of State	2

THURSDAY, JULY 16, 1981

Reuss, Hon. Henry S., chairman of the Joint Economic Committee: Opening statement	63
Volcker, Hon. Paul A., Chairman, Board of Governors of the Federal Reserve System	63

SUBMISSIONS FOR THE RECORD

TUESDAY, JULY 14, 1981

Long, Hon. Gillis W.: Letter to Representative Long from Richard Fairbanks, Assistant Secretary for Congressional Relations, Department of State, dated August 20, 1981, with an enclosure, responding to written questions posed in a July 17, 1981, letter	60
Rashish, Hon. Myer: Prepared statement	2
Reuss, Hon. Henry S.:	
Excerpt from Public Law 95–118 regarding the U.S. Government's advancement of the cause of human rights	25
Letter to Representative Jerry Patterson, chairman, Subcommittee on International Development Institutions and Finance, Committee on Banking, Finance and Urban Affairs, from W. Dennis Thomas, Assistant Secretary, Legislative Affairs, Department of the Treasury, dated July 1, 1981, with attachments, regarding a prospective change in U.S. voting policy on multilateral development bank loans to Argentina, Chile, Paraguay, and Uruguay	29

THURSDAY, JULY 16, 1981

Rousselot, Hon. John H.: Opening statement	76
Volcker, Hon. Paul A.: Prepared statement	64

THE OTTAWA SUMMIT AND U.S. INTERNATIONAL ECONOMIC POLICY

TUESDAY, JULY 14, 1981

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The committee met, pursuant to notice, at 10 a.m., in room 5110, Dirksen Senate Office Building, Hon. Henry S. Reuss (chairman of the committee) presiding.

Present: Representatives Reuss and Richmond.

Also present: James K. Galbraith, executive director; Charles H. Bradford, assistant director; and William R. Buechner, Kent H. Hughes, and Marian Malashevich, professional staff members.

OPENING STATEMENT OF REPRESENTATIVE REUSS, CHAIRMAN

Representative REUSS. Good morning. The Joint Economic Committee will be in order.

Our witness, the Honorable Myer Rashish, is testifying before another committee and will be here any minute now, as he explained to me, and this is well understood. He, unfortunately, has to be at the White House to brief the President on Ottawa at 11:15 a.m., so he asked, and I agreed, that his very comprehensive prepared statement be printed in full into the record. His statement is available to the press, and as soon as he appears we shall proceed with questioning.

Before we do proceed, however, I might call everyone's attention to the two charts [indicating]—very admirable charts—which were just put up.

The first chart on the left shows what we all know, that United States real interest rates are at a historic high. We now have higher real interest rates than at any time perhaps in our history, and certainly in the past 5 years. Interest rates have risen both absolutely and in relation to inflation.

The black line on the left-hand chart shows the annual inflation rate in the Consumer Price Index and shows that from 1975 to 1980 interest rates were below the rate of inflation. In early 1980, however, the situation changed and interest rates then broke through the inflation line. Today we have the astounding situation of a 14.6 percent rate on 3-month Treasury bills compared with an 8.2 percent rate of inflation on the Consumer Price Index.

No wonder our comrades at arms at Ottawa are deeply upset.

The second chart shows the effect of exporting our high interest rates around the world. Using the most recent figures for this May and, again, using the 3-month Federal bill rate, the United States

rate in May was 16.3 percent. Compare that with the other countries, all of which, with the exception of Japan, display a similar high rate of interest. Canada, 19 percent; France pushing 16 percent; Germany, 13 percent; Italy pushing 20 percent; and the United Kingdom, more than 12 percent.

It's a set of charts worth pondering and we will now ponder until Mr. Rashish is able to get here.

Good morning, Mr. Secretary.

Mr. RASHISH. Good morning. I'm sorry to be late.

Representative REUSS. We are delighted to see you and as I just explained, we all know your rough schedule this morning. We have admitted, Mr. Secretary, your prepared statement to the record as discussed by you and me last night, and I understand that you must depart for the White House at about 11 a.m. Is that still correct?

Mr. RASHISH. I have an 11:15 a.m. meeting.

Representative REUSS. We'll see that you get out of here at 11 a.m. and I would simply, by way of opening, tell you how delighted we are at your appointment, how proud we are of the administration for appointing you, how grateful we are for your many years of good advice and learning and common sense which you have given the Joint Economic Committee. Needless to say, all 20 members of the Joint Economic Committee wish you well and look forward to working closely with you toward goals which—from your prepared statement for the record—are substantially shared, I think, by members of this committee.

STATEMENT OF HON. MYER RASHISH, UNDER SECRETARY FOR ECONOMIC AFFAIRS, DEPARTMENT OF STATE

Mr. RASHISH. Thank you very much, Mr. Chairman. I can't quite say that sitting on this side of the table I feel completely at home, but I do feel more at home in the Joint Economic Committee than I would had I not had so many years in close association with you and the committee and its staff. I'm delighted to be here. I'm sorry that I only have now about 50 minutes available, but I'm at your disposal. I don't suggest that it would be useful to read this long prepared statement since that would consume all the time.

Representative REUSS. Since you got it to us last night, we had a chance to read it.

Mr. RASHISH. It might be construed as a filibuster if I tried. I thought what I might do just for openers was to read parts of it.

Representative REUSS. If it's all right with you——

Mr. RASHISH. Just forgo the whole thing?

Representative REUSS. Forgo it——

Mr. RASHISH. I haven't read it myself, frankly. [Laughter.]

Representative REUSS. Well, you inherited a great staff and they did a fine job.

[The prepared statement of Mr. Rashish follows:]

PREPARED STATEMENT OF HON. MYER RASHISH

I am pleased to appear before this committee in its consideration of foreign economic policy. This Committee, and you in particular, Mr. Chairman, have played a prominent leadership role in making the American people aware of the importance of a vigorous U.S. international economic policy to the health of the U.S. economy and to our foreign policy objectives.

Mr. Chairman, we both are concerned about many of the same issues. From our respective vantage points in the executive and legislative branches, we share a responsibility for establishing the crucial linkages between foreign economic policy, on the one hand, and both U.S. foreign policy objectives and domestic economic policy objectives, on the other. It is the close connections among these three policy dimensions that I wish to emphasize in my presentation today.

I am sure that the Committee will agree that in today's world, economic issues are increasingly becoming the very stuff of foreign policy. This is clearly illustrated by the intensive preparations now under way for the Ottawa Summit. The economic and political issues which the heads of government will be discussing at Montebello, just outside of Ottawa, are so closely intertwined as to be inseparable.

On the other hand, foreign economic issues are increasingly tied to the operation of the domestic economy. Trade now represents nearly twice as high a percentage of our national product than it did ten years ago. (In 1970 U.S. exports constituted 4.5 percent, and today they constitute 8.4 percent of our GNP.) U.S. monetary policy and its implications for the macro-economic policies of our chief trading partners are among the chief concerns of the political leadership in Europe and Japan. Inevitably, the Administration's goals for the domestic economy will affect—and be affected by—developments on the international scene.

Ultimately, our responsibility is to craft and implement a U.S. foreign policy which takes into account all our interests—our security needs, our resource requirements, our trade and investment concerns, our need for good working relations with the many countries a world power must deal with in today's interdependent world. Of course, the success of such a foreign policy is dependent on a dynamic domestic economy. The President's economic recovery program is thus central to our foreign economic policy, and the role the State Department plays in foreign policy rests on close coordination with the agencies primarily responsible for our domestic economy.

I would like to illustrate this general approach to foreign economic policy by briefly reviewing with you five principal areas of concern:

Energy supply and independence;
Trade;
International investment and finance;
Support for economic development, and finally
The very special economic ties we have with our closest allies and neighbors.

I. ENERGY

While rapid oil price rises and occasional supply interruptions can cripple economic growth and increase inflationary pressures in consuming countries, it is the national security implications of the unhealthy dependence of the United States and the other major industrialized countries that are most disturbing to this Administration. It is impossible to think about such widely disparate issues as the Middle East peace process, the present condition of the international monetary and commercial banking systems or the financial solvency of key developing countries without reaching back to the dependence of the international system on imported oil and on a small group of oil suppliers.

To reduce that dependence, this Administration is emphasizing, in the first instance, market-oriented policies to enhance supply and to restrain demand. A key element has been the President's decision to implement a realistic energy pricing policy. Oil price decontrol and eventual deregulation of natural gas prices are essential steps in eliciting increased production and discouraging inefficient use of energy. Other important supply-oriented policies are now under development. We aim to accelerate leasing of off-shore oil, resolve regulatory and institutional problems inhibiting the use of nuclear power, and remove impediments to increased production, use and export of coal. Our extensive coal resources need to be developed; we are confident that private industry will be able to expand output and improve infrastructure for delivery of coal exports as long as government provides a reasonable regulatory climate.

The U.S. response to market forces in energy has been impressive. Oil consumption in the first half of 1981 is running at 16 million barrels per day, the lowest level since 1973. Oil imports for the half year are running just over 5 million barrels per day, three and a half million barrels per day below the 1977 peak. The decline in U.S. domestic oil production has, at least temporarily, been halted. Yet increased production and more efficient energy use in the United States addresses only part of the energy problem. Preparedness to adjust to energy market disruptions is vital. Supplies can be disrupted, as we have seen, by political conflict and social upheaval, and by sudden demand surges. The obvious examples of these dangers stem from the Middle East; less visible is prospective Western European dependence on the

Soviet Union for substantial amounts of natural gas which has the potential for unhea'thy influence.

We must be prepared to counter these threats to our energy security by national action and international cooperation. Nationally, an effective strategic petroleum reserve is crucial. The reserve is the basis for crude oil security, to be used in response to a major oil supply interruption and in the framework of a response coordinated with our partners in the International Energy Agency.

Purchases of curde oil for the Strategic Petroleum Reserve (SPR) were resumed in October of last year at a rate of about 100,000 barrels per day. The fill rate has accelerated sharply in the past six months. Since the beginning of fiscal year 1981, 70 million barrels have been added to the Reserve, bringing the total in storage as of June 30 to 163 million barrels. The current oversupply of crude oil in world markets and resulting lower prices have enabled us to achieve a faster than anticipated fill rate. We now expect to have approximately 200 million barrels in storage by the end of fiscal year 1981, taking into account contracts already signed and projected purchases. This will be an important step towards our currently scheduled 1989 target of 750 million barrels.

While a petroleum reserve is one element of our energy and national security policy, other elements, involving international cooperation, are also required. It would be a serious mistake to believe that U.S. energy supply or national security could be maintained in a world in which our Allies were crippled and the world trading economy sundered by serious price shocks or supply disruption. For this reason, cooperative efforts with other industrialized countries are fundamental to our energy security policy. The International Energy Agency is the prime forum for this cooperation. The IEA emergency oil sharing system, designed to counter catastrophic shortfalls, is the keystone of this energy security policy. In addition, we have learned also from the recent past that smaller, or even threatened, shortfalls can also lead to harmful price rises and IEA consultations are underway to try to find appropriate contingency measures for these situations.

A sound energy policy also requires good relations with reliable producers. Investment climates need to be improved; discriminatory policies, such as those in our neighbor to the North, favoring domestic investment can reduce optimal energy investment to everyone's detriment.

Mr. Chairman, we will not relax our search for energy security in the face of the current oversupply of crude oil on world markets. This quest for energy security will probably bring us into contact with almost every conceivable aspect of foreign and economic policies and we are prepared to ensure that our policies reflect that critical objective.

II. TRADE

Current challenges in the trade field arise out of the success—in both foreign policy and economic terms—of the basic policies adopted after World War II. The U.S. goal then in establishing the GATT and urging our trading partners to establish a more open and market-oriented trading system, was to increase both world prosperity and international interdependence through the expansion of trade. World trade expanded fivefold between 1970 and 1980, while OECD exports as a share of GNP rose from 10.7 percent to 16 percent. By 1979 the average tariff levels in the developed countries had fallen to 10.6 percent. The cuts agreed to in the Tokyo Round of multilateral trade negotiations will further reduce tariff levels to 4.5 percent.

We need to continue this expansion of trade which has contributed so much to our prosperity and added stability to the international environment. Last week, Ambassador Brock presented to the Senate Banking and Finance Committees a comprehensive Administration policy statement outlining our approach to trade. The approach emphasizes that it remains important to strengthen the institutions which have served us well in the trade field, principally GATT. We will be facing a number of new challenges, however.

U.S. trade with the Soviet Union and Eastern Europe has expanded considerably during the 1970s, with these countries providing significant markets particularly for U.S. agricultural products. Our exports of wheat and coarse grains to the USSR in 1979/80 came to 15.2 million tons. While we recognize the important contribution these exports have made to the U.S. economy, we cannot view economic exchanges in isolation. This Administration is determined to ensure that economic relations with the East are consistent with broad U.S. political and strategic objectives. On the other hand, we recognize that continued economic ties between these countries and the U.S. and the rest of the world can be in our interest, particularly to the extent that these ties serve to reinforce the East's stake in the orderly functioning of the world economy and to encourage them to engage in responsible international

behavior. For both economic and political reasons, therefore this Administration intends to maintain a prudent level of economic relations, with due regard for security interests and for the differences between our market-oriented economy and their centrally planned systems.

We need to balance our desire to increase exports against our other interests, including the need to avoid having U.S. exports contribute to the military potential of the recipient country.

The U.S. cannot have an effective policy on trade with these countries unless our policy is in harmony with that of our major trading partners. We need to achieve a common perception of the balance between security and commercial interests for the Western allies as a whole.

The problems of fair trade are peculiarly difficult to deal with in the case of countries which do not apply market pricing principles within their own economies. The concepts of dumping and subsidies have no place in their system, but the U.S. government must deal with them as they impact trade in the U.S.

In the trade field as in the political sphere, there are important differences among the Eastern European countries. Some are more open to international trade than others; some have moved toward instituting a genuine pricing system and effective tariffs; four are members of the GATT. In addition, they are at differing levels of economic development. This Administration will make every effort where possible to tailor our approach to the individual country.

Our trade with other countries is less likely to raise security issues but is of crucial importance nonetheless.

We are concerned that trade be conducted according to mutually agreed "rules of the game". One of the major accomplishments of the Tokyo Round was to make a start at dealing with the nontariff barriers which, in an era of relatively low duties, act as the major impediment to international trade. The "codes" agreed to during these negotiations are being put into effect. We need to make them work as effectively as possible, and to develop greater international discipline and a body of case law in such key fields as the use of export subsidies, dumping, and international bidding for government procurement.

In addition, a number of areas important to U.S. trade have hitherto not been the subject of much international discipline. Trade in services and the potential trade distortions from the investment performance criteria and incentives adopted by a number of countries are but two examples that come to mind. Trade in services is one of the most dynamic components in our economy. Our 1979 export receipts in this area totaled more than $76 billion. That is almost a four-fold increase over the 1971 level of $19.1 billion. Services account for 27 percent of U.S. exports and employ 70 percent of the non-agricultural U.S. work force.

In both areas we need to develop an international consensus which will facilitate trade and discourage back-door means of protectionism.

The emergence of China as an important actor in the world trade arena poses challenges and opportunities for U.S. businessmen and policy makers, as well as for the world trading system as a whole. China's exports increased from $8 billion in 1977 to over $13.5 billion in 1979. China's imports over the same period grew even more rapidly from $6.6 billion to $14.7 billion.

Another challenge we must meet stems from the increasingly important role of the developing countries in world trade. Our trade with the developing countries has expanded rapidly over the past decade: imports by 25 percent per year, exports by 18 percent per year, compared with 15 percent increases in trade with the developed countries. The less developed countries as a group account for 36 percent of our exports and 47 percent of our imports and they are now a more important trading partner for the U.S. than the EC, Canada or Japan. (Tables 1-2.)

Within this group, a small number of countries often referred to as the "newly industrializing countries" [1] accounts for over half of trade between the U.S. and non-oil LDCs. The U.S. needs to respond to their competition in a way which will encourage world prosperity and will increase the stake these countries have in an orderly world trading system. Given their importance as an export market, maintaining an open U.S. market is essential to our export expansion strategy as well. This Administration will be encouraging the developing countries generally, and the more advanced in particular, to take on the disciplines of the international trading system.

The other non-oil developing countries urgently need to increase their exports in order to finance increasingly expensive imports. Export earnings are a more significant source of development finance than aid, both in terms of the amount of money involved and by virtue of the economic efficiency which a successful export industry

[1] Mexico, Brazil, Singapore, Hong Kong, Taiwan, Korea, Israel.

represents. Although U.S. aid totaled $4.7 billion in 1979, in that year U.S. imports from LDCs totaled $92.5 billion, and nearly half of this ($43.7 billion) came from the non-OPEC LDCs. Keeping our market open to the exports of developing countries, and providing the very modest degree of incentive embodied in our Generalized System of Preferences scheme, are integral parts of our broader policy with respect to these countries. (Tables 3–4.)

Although my main theme today is the "foreign" aspects of foreign economic policy, I cannot leave the subject of trade without a word about the competitiveness of U.S. industry. U.S. efforts to continue the progress made so far in developing a more orderly trading system, and to respond to the new challenge of the developing countries, will ultimately fail unless they are backed by a vigorous U.S. economy. In our response to the difficulties caused by import competition in sensitive sectors, we need to ensure that we encourage economic efficiency rather than rewarding weakness. Adjustment assistance and safeguard measures can ease the problems firms and workers face as our economy adapts to new circumstances, but we will be relying primarily on market forces to bring about the necessary adjustment.

On the export side, the overall health of the economy, once again, will be the key factor in determining how well our products do. The amount and effectiveness of investment, our ability to control inflation, and the growth in productivity are all crucial.

The Administration is also reviewing various aspects of U.S. law and policy which have had the unintended side effect of discouraging exports, such as the Foreign Corrupt Practices Act and the operation of our export controls. The Administration is also working internationally to reduce barriers to U.S. goods.

III. INTERNATIONAL FINANCE AND INVESTMENT

In an increasingly interdependent world, the smooth operation of the financial system is a vital prerequisite to increasing world trade, and both are equally essential to prosperity. The 1979–80 oil price increase resulted in an OPEC current account surplus of about $120 billion last year, nearly double the 1979 level. The counterpart to this enormous surplus was a $47 billion deficit among the non-oil developing countries. Whether OPEC's surpluses will remain a "sword of Damocles" hanging over the international financial system depends considerably on the future path of oil prices and on the ability of deficit countries to use the current lull in rising energy costs to implement the structural reform of their economies necessary to right their external accounts.

It is expected that the OPEC surplus and the industrialized countries' deficit will moderate this year to about $100 and $20 billion respectively. The industrialized countries should be able to finance their deficits with little trouble. For the most part, their countries are following slow growth and anti-inflationary policies and thus adjusting to the higher relative costs of oil.

The non-oil LDC's combined current account deficit is likely to rise somewhat, to upwards of $95 billion. We do not expect this to cause a generalized debt problem. However, those countries that do not move to implement sound economic policies will find access to external finance more limited and more costly than previously.

The international financial system can ill affort a repetition of the policies of the mid-1970's, when many countries tried to finance growth through domestic credit expansion and external borrowing. Even with a lull in the rising price of energy, and the possibility that OPEC's surplus will dwindle rapidly, 1981 is quite different from 1973–75. Many countries already have incurred considerable new debt, and a larger proportion is on commercial terms. Interest rates are higher both in nominal and real terms. Thus, those countries dependent on external finance from commercial sources must run that much faster just to be able to serve a given level of debt. Debt service now absorbs 20 percent of these countries' export earnings, up from 13 percent in mid-1970's.

The private markets are quite liquid and the supply of funds to creditworthy countries is unlikely to be a problem. However, many banks are reaching their own external limits on exposure, and they will be increasingly selective in adding new exposure.

It is essential that we begin to explore longer term solutions to the recycling problem. Private banks will undoubtedly continue to play the predominant role in the recycling process. However, the IMF, through access to its own resources and its influence on the judgments of the private market, will play a more pivotal role in countries with balance of payments problems.

To do so, the IMF has been given more flexibility. Resources available from the IMF have been increased and the terms of repayment extended in some cases in recognition of the longer periods required to implement effective adjustment programs under current international economic conditions. The guidelines for condi-

tionability—domestic programs required of borrowers under IMF programs—have been modified to take more explicit account of the underlying causes of the financing problems as well as the borrowing countries' social, political and economic priorities.

The Fund borrowing of $5–6 billion over the next several years (including from Saudi Arabia) will help bolster the IMF's ability to supply balance of payments financing and, to the extent that other can be involved, bring the surplus OPEC countries more directly into the recycling process.

We are encouraging this expansion of the IMF's role and resources. We believe that a multilateral institution like the IMF is especially well placed to encourage developing countries to adjust their economic policies, as we believe they must, to current international realities. The economic stakes for the countries concerned are very high. So are the foreign policy and economic stakes for the U.S., if failure to encourage adequate adjustment were to result in the economic collapse of countries important to the U.S.

With this in mind, the Reagan Administration has also reviewed its approach to international monetary policy. Our basic principle is that the marketplace should be allowed to work. Accordingly, we will intervene in foreign exchange markets only when necessary to counter disorderly market conditions. We believe that this is consistent with the Administration's efforts to address economic fundamentals rather than attempt in vain to fine-tune our approach. We hope that the emphasis on basics will reduce the likelihood of disorderly foreign exchange markets.

Given the size of the U.S. economy and its international trade and financial linkages, U.S. monetary and fiscal policies are legitimately of major concern abroad. Right now we are going through a difficult transitional phase. The clash between our anti-inflationary monetary policy and deep-seated inflationary expectations has temporarily produced very high interest rates, causing painful effects in our own economy, and complicating policy choices for our economic partners. High U.S. rates have added to downward pressures on the exchange value of some foreign currencies, and have contributed to the increase in interest rates abroad, even though some policymakers abroad would have preferred lower rates in support of investment and economic recovery. I would like to underline, however, that domestic economic conditions and political factors in the U.S. and many of our key trading partners have been the principal cause of exchange rate and interest rate developments. Lower interest rates can be attained on a sustainable basis only by reducing the rate of inflation and the inflationary expectations which are built into present high nominal rates.

We are sometimes charged with placing an undue burden on monetary policy in the anti-inflationary fight and thus aggravating the interest-rate problem. While monetary control surely is a necessary condition for reducing inflation, the Administration has also proposed a restrictive fiscal package and expects to have the smallest deficit as a share of GNP among the major countries. Over the next few years fiscal policy will be guided by the commitment to balanced budgets.

These issues have been discussed with our partners in the OECD, in the Summit preparatory meeting as well as bilateral meetings. Much progress has been made in enhancing mutual understanding, and, given the common objective of restoring vigorous, non-inflationary growth, I believe a further convergence of views is probable at the Summit.

Turning briefly to investment policy, we believe that market forces rather than government fiat result in the most efficient distribution of investments. Consistent with this view, U.S. investment policy has for many years been based on the principle of nonintervention in the private sector decision-making process. As a corollary, the U.S. Government has avoided actively promoting or discouraging private investment overseas. Our policy supports a general principle of national treatment for foreign enterprises—i.e., foreign enterprises should be treated no less favorably than domestic investors in like situations.

U.S. investment overseas has been increasing in recent years. By the end of 1979 (on a balance of payments basis), the stock of U.S. direct investment abroad had reached an estimated $192.6 billion, up 15 percent from the previous year's figure of $167.8 billion. U.S. investment in Europe and Canada account for over half of U.S. investment abroad (about $122 billion), and investment in developed countries comes to about 72 percent of the total. We should also keep in mind that receipts from those investments totalled nearly $38 billion in 1979. (Table 5.)

The U.S. has maintained an open investment climate, and we believe that the attractiveness of the U.S. investment climate has led to a largely beneficial increase in investment in this country. As a general principle, foreign investors should not receive any special advantages which are not available to domestic investors in the U.S. economy.

Most OECD countries maintain a similar open investment climate, though we are concerned about trends in the other direction in Canada and have been discussing this issue with the Canadian government. Developing countries are in some cases more restrictive. We want to remove U.S. Government impediments to U.S. investment abroad—for example, in the tax and regulatory area. We also want to ensure that U.S. investors overseas receive fair and equitable treatment. We will, for instance, seek greater international discipline in the use of investment incentives and performance requirements. We will continue to work, bilaterally and multilaterally, for the goal of an open investment system—one that is based to the extent possible on a common framework and understanding of the basic ground rules.

IV. SUPPORT FOR ECONOMIC DEVELOPMENT

Support for economic development in poorer countries has been an important element in U.S. foreign policy for the past thirty years, and given the economic and strategic picture of some key developing countries it is likely to remain so for some time to come.

This Administration has been taking a careful look at our economic policies toward developing countries, to make sure that U.S. policies accord closely with our tangible economic and security interests in such sensitive areas as the Caribbean Basin, the Middle East, the areas bordering Afghanistan and the Persian Gulf, and others. Aid allocations will reflect these interests as well as humanitarian concerns.

Historically, U.S. aid has been extended both as direct bilateral assistance and through multilateral institutions. The Administration is examining the balance between these channels, in an attempt to assure that our choice of aid tools reflects the different interests our aid programs should serve. We plan to complete by September a review of U.S. policy on participation in future replenishments or expansions of multilateral development banks.

U.S. budget revisions have affected all areas, including foreign assistance. Our essential aid expenditures in fiscal year 1982 will nonetheless be about 15 percent above the current fiscal year.

This Administration believes it important to emphasize, however, that economic development includes other elements besides aid. One of the most important steps this administration can take for development is to restore and maintain a growing U.S. economy without inflation. This encourages the development process through linkages that are often more important than external aid flows. The most important among these are:

Markets open to the exports of developing countries;

Domestic economic policies that facilitate overall growth and investment in these countries; and

Access to capital markets.

Even within the broad category of external financing of development, concentration on the relatively small official aid contributions sometimes leads us to forget the much larger flows from the rest of our economy. U.S. imports from developing countries in 1979 were nearly nine times our official aid flows. The same type of relationship holds for all the western aid-giving nations as a group. U.S. direct investment in the developing countries runs at or above the level of aid, and LDC use of private capital markets results in commercial bank loans and bond issues for exceeding development assistance. In 1979 alone, commercial banks provided $37 billion to the LDCs, while flows of official development assistance from all DAC donors were $22 billion.

These factors suggests that the U.S. should pay greater attention to the role of the private sector in the development process. U.S. business is involved directly in trade, investment, technology transfer and financing in the developing world, and the private sector in many developing countries could, with the proper encouragement, play a much greater role. The Administration, in consultation with the business community, is reviewing what can be done to facilitate private sector involvement in the development process, while fully respecting its private character.

Relations between developing and developed countries have also been the focus of a great deal of international debate in recent years. The U.S. has been an active participant in this dialogue, as I am sure you are all aware. We participated in last year's effort to work out a suitable agenda and procedures for Global Negotiations. Because we took this process seriously, we felt that it was essential to include provisions that would protect essential U.S. interests and preserve the integrity of existing international institutions. In view of the continuing disagreements among the countries concerned on how such negotiations should be set up, the Administration proposed to the UN General Assembly last May that the issue of global negotiations be deferred until the next General Assembly in the fall.

Cancun Summit

As an indication of the importance we attach to these issues, President Reagan has accepted an invitation from President Lopez Portillo of Mexico to attend an International Meeting on Cooperation and Development in Cancun on October 22 and 23. We view this meeting as a useful opportunity for President Reagan to meet with heads of government from 22 industrialized and developing countries for an exchange of views on global economic problems and opportunities. The eleven co-sponsoring nations have told us they plan an open and informal meeting, with no set agenda and no communique. We expect that the discussion will include such vital issues as food, energy, trade, population growth, and world ecological developments. The heads of government may also consider whether global negotiations are a useful forum for addressing them, though we hope the focus at Cancun will be more substantive than procedural.

We prefer to postpone any decision on global negotiations until the heads of government have had a chance to exchange views at Cancun. We plan to work closely with the Ottawa Summit countries and other participants to ensure that the Cancun Summit is as constructive as possible.

V. ECONOMIC RELATIONS WITH KEY FRIENDS

The administration attaches special importance to our economic relations with certain key friends whose ties to the U.S. are particularly intimate and long-standing. We have moved, through close cooperation at all levels of our governments, to strengthen our economic ties with our neighbors on the North American continent. These relations received a strong boost from the warm rapport that President Reagan has developed with his counterparts in Canada and Mexico.

The Summit Meeting: One of the duties which I have assumed is that of the President's personal representative for economic summits. The preparatory process for the July 19-21 Ottawa Summit was launched in earnest in February when the personal representatives of the seven participating countries plus the European Community met in London. Since then the representatives have met three times—in late April, early June, and early July. In these meetings we developed a work program and reviewed papers presented by individual personal representatives on relevant topics. The preparatory process has been very important in crystallizing the key issues and improving communications among our governments. As a result, the importance on domestic economic recovery in all our countries emerged as a dominant theme. There is a general consensus that our capacity to strengthen our security, to expand assistance to developing countries and to resist protectionist actions all hinge upon controlling domestic inflation and expanding output.

In addition to domestic economic policies, such issues as economic relations with the Soviet Union and Eastern Europe, our relations with developing countries and energy and trade will be central issues for discussion. Obviously, when the Heads of Government meet, they will touch on international political issues of concern at that moment. The Summit will provide President Reagan with an excellent opportunity to explain his domestic economic recovery program and to provide the framework within which he will pursue his policies on these various international issues. This Summit should result in a greater understanding of U.S. policies and we and our allies hopefully will come away with a commitment to common approaches for dealing with some of the issues. In our preparatory work to date, I sense that our allies share this view. We will, of course, discuss U.S. policy on these issues with others of our allies who are not participating in the Summit.

The Ottawa Summit scheduled for July 19-21 is the seventh annual meeting of the heads of government. In comparison with previous summits, we expect the discussion to be more free-wheeling and the communique less detailed. With this session, the first round of Summits will have been completed. We believe that these Summits have been valuable thus far as a forum for an intimate exchange of views among heads of government.

CONCLUSION

Given the complexity of global U.S. interests, it is risky to pick out a few guiding themes for U.S. foreign economic policy. Let me conclude by trying to do so nonetheless.

First, in all aspects of our foreign economic policy the U.S. needs to integrate to the fullest our economic and our security interests.

Second, the Administration believes in the efficiency of the marketplace, and has considerable skepticism about the effectiveness of government efforts to supplant it. This belief will affect the Administration's views on the policy tools it believes our

government and others should use in pursuit of our economic and foreign policy objectives.

Third, the Administration is persuaded that a more effective integration of the world economy is essential to our well-being both economically and politically. Vigorous and fair trade, a world investment climate which encourages the development of productive enterprises, smoothly functioning financial markets, and the sound economic expansion of the developing countries—these are the key requirements for a more integrated world economy. Moreover, they contribute to an international environment in which the U.S. can more effectively pursue its broader foreign policy goals.

Fourth, we are aware of the economic interdependence between the U.S. and our allies and the ramifications U.S. economic policy has for political relations. We believe that the President's economic recovery plan will lay the foundation not only for a more vigorous U.S. economy, but also for stronger and healthier ties with our allies. We have also sought more directly in these first months to bolster our general economic relationship with the other members of the Western Alliance. Our initiatives to enhance energy security, to place East-West trade in a broader political context and to reduce tensions resulting from trade issues have resulted in a generally good spirit of mutual cooperation within the Alliance.

Looking toward the Ottawa Summit, our Allies generally support our desire to move away from a discussion of detailed economic issues that characterized past Summits to a more general and free-wheeling discussion among heads of state which would seek to highlight the areas of shared perceptions. We are confident that this spirit will help the Summit countries—and the Western Alliance—meet the challenges of the next decade.

Mr. Chairman, I have sought to provide the Committee with a broad brush view of the Administration's international economic policies. Nevertheless, I would like to reiterate that the Administration is still in the process of reviewing important elements of that policy. As we progress in fleshing out our policies in these critical areas, I will, of course, be prepared to keep the Committee fully informed and to come back and discuss these vital issues with you, Mr. Chairman and the members of your Committee.

TABLE 1.—U.S. TRADE WITH DEVELOPING COUNTRIES

[Dollar amounts in billions]

	1979		1980	
	Amount	Percent	Amount	Percent
U.S. imports:				
Total	$207.13	100.0	$241.2	100
All LDC's	92.42	44.6	113.5	47
Oil exporters	48.7	23.5	51.2	21
Nonoil LDC's	43.7	21.1	62.3	26
U.S. exports:				
Total	181.8	100.0	220.7	100
LDC	63.0	34.6	81.1	36
Oil exporters	15.1	8.3	16.6	7
Nonoil LDC's	47.9	26.3	64.5	29

Source: Highlights of U.S. Import and Export Trade–FT–990, December 1980.

EXPORTS DUE TO AID PROGRAMS

[In millions of dollars]

	1973	1979
Public Law 480	707	1,205
U.S. aid	638	748
Total	1,345	1,953

Source: Overseas Business Reports, OBR 80–35, "U.S. Trade With Major World Areas 1973–1979," USDOC.
Percent of trade with nonoil LDC's: 4 percent.

TABLE 2.—MAJOR LDC TRADING PARTNERS OF UNITED STATES (FAS)

[In billions of dollars]

	1980 U.S. imports from	1980 U.S. exports to
Brazil	3.7	4.3
Hong Kong	4.7	2.7
Korea	4.1	4.7
Israel	.9	2.0
Mexico	12.5	15.1
Singapore	1.9	3.0
Taiwan	6.9	4.3
Nigeria	10.9	1.1
Saudi Arabia	12.5	5.8
Venezuela	5.3	4.6
Subtotal	63.4	47.6
Other LDC's	50.1	33.5
Total for LDC's	113.5	81.1

TABLE 3.—U.S. GSP IMPORTS

[Dollars in billions]

	1979 value	1980 value	1979 GSP as a percent	1980 percent
GSP imports	$6.3	$7.3	.....	.....
Total U.S. imports	207.1	241.2	3	3.0
Nonpetroleum imports	147.0	162.0	4	4.5
Imports from LDC's	92.4	113.5	7	6.4
Imports from non-OPEC LDC's	43.7	62.3	15	[1] 12.0

[1] Excludes GSP imports of $79,000,000 from oil exporters—Venezuela, Indonesia, Ecuador.

GSP Manufactures imports from LDC's were about 25 percent of total manufactures imports from LDC's in 1979 and 1980.

TABLE 4.—U.S. IMPORTS UNDER GSP FROM PRINCIPAL BENEFICIARIES

[Dollars in millions]

	Amount GSP duty free	Percent of total U.S. GSP
1979:		
Taiwan	1,721	27
Korea	750	12
Hong Kong	629	10
Mexico	546	9
Brazil	546	9
Israel	283	5
Singapore	232	4
Yugoslavia	166	3
India	137	2
Philippines	137	2
Total	5,147	83
1980:		
Taiwan	1,835	25
Hong Kong	804	11
Korea	776	11
Mexico	509	7
Brazil	442	6
Singapore	301	4

TABLE 4.—U.S. IMPORTS UNDER GSP FROM PRINCIPAL BENEFICIARIES—Continued

[Dollars in millions]

	Amount GSP duty free	Percent of total U.S. GSP
Israel	231	3
Argentina	213	3
Yugoslavia	177	2
India	139	2
Total	5,427	74

TABLE 5.—U.S. DIRECT INVESTMENT POSITION ABROAD, 1977–79

[Millions of dollars]

	Position, yearend 1977	Addition in 1978				Position, yearend 1978	Addition in 1979				Position, yearend 1979
		Total	Equity and intercompany account outflows (inflows (−))	Reinvested earnings of incorporated affiliates	Valuation adjustments		Total	Equity and intercompany account outflows (inflows (−))	Reinvested earnings of incorporated affiliates	Valuation adjustments	
All areas	149,848	17,957	4,877	11,469	1,611	167,894	24,844	5,994	18,414	525	192,040
Petroleum	31,420	2,370	412	1,335	603	33,790	7,764	2,730	4,979	54	41,553
Manufacturing	66,033	8,047	1,587	6,152	309	74,080	9,484	1,236	8,139	109	83,566
Other	52,395	7,540	2,877	3,962	700	39,934	7,596	1,938	5,296	362	67,531
Developed countries	106,225	12,246	2,227	8,573	1,446	130,471	17,486	2,542	14,569	496	137,927
Petroleum	24,851	2,021	225	1,029	767	26,871	4,949	737	4,096	115	31,821
Manufacturing	53,709	6,149	1,064	4,833	232	59,858	7,508	548	6,858	103	67,366
Other	29,665	4,077	918	2,711	448	33,742	4,996	1,258	3,553	187	38,761
Canada	35,200	1,871	−000	1,724	747	37,071	3,962	915	2,884	164	41,033
Petroleum	7,660	586	−437	564	459	8,246	922	5	828	88	9,168
Manufacturing	16,696	782	41	679	62	17,477	1,700	380	1,320	60	19,277
Other	10,844	503	−204	481	225	11,347	1,281	530	736	16	12,628
Europe	60,930	8,623	2,447	5,665	512	69,553	11,910	1,246	10,522	142	81,463
Petroleum	13,947	1,175	728	213	234	15,122	3,433	439	2,947	47	16,556
Manufacturing	31,672	4,633	937	3,572	125	36,304	4,942	−119	5,039	22	41,246
Other	15,311	2,815	782	1,880	153	18,127	3,535	926	2,536	73	21,662
Other	12,095	1,752	380	1,184	188	13,847	1,584	382	1,103	99	15,431
Petroleum	3,244	259	−67	252	74	3,503	595	293	323	−20	4,096
Manufacturing	5,342	734	107	582	46	6,076	807	287	499	21	6,882
Other	3,510	759	340	351	69	4,289	182	−196	281	96	4,451
Developing countries	34,462	5,937	2,864	2,864	236	40,399	7,441	3,749	3,573	130	47,841
Petroleum	3,520	841	554	396	−109	4,361	2,870	2,068	843	−61	7,231
Manufacturing	12,324	1,896	503	1,319	77	14,223	1,975	688	1,281	6	16,196
Other	18,618	3,197	1,806	1,149	241	21,816	2,596	972	1,450	175	24,412
Latin America	28,110	4,553	2,204	2,096	253	32,662	4,172	1,454	2,589	129	36,834
Petroleum	3,489	403	218	187	−2	3,892	676	38	623	15	4,565
Manufacturing	10,063	1,648	432	1,119	96	11,712	1,509	621	918	−30	13,220
Other	14,557	2,502	1,554	791	157	17,059	1,987	794	1,048	144	19,046
Other	6,353	1,384	000	768	−45	7,737	3,270	2,295	964	−9	11,007

TABLE 5.—U.S. DIRECT INVESTMENT POSITION ABROAD, 1977–79—Continued

[Millions of dollars]

	Position, yearend 1977	Addition in 1978				Position, yearend 1978	Addition in 1979				Position, yearend 1979
		Total	Equity and intercompany account outflows (inflows (−))	Reinvested earnings of incorporated affiliates	Valuation adjustments		Total	Equity and intercompany account outflows (inflows (−))	Reinvested earnings of incorporated affiliates	Valuation adjustments	
Petroleum	31	438	336	210	−107	469	2,194	2,050	219	−76	2,662
Manufacturing	2,261	250	71	200	−21	2,511	467	67	364	36	2,978
Other	4,061	696	254	358	84	4,757	610	178	401	31	5,366
International and unallocated	7,100	−227	−215	31	−43	6,934	−54	−367	332	1	6,590

Source: Department of Commerce, Bureau of Economic Analysis.

TABLE 6.—GLOBAL PAYMENTS PATTERNS[1]

[In billions of dollars]

	1978	1979	1980
A. Current account balances, excluding official transfers:			
OPEC	−3	+67	+124
OECD	+27	−14	−50
Non-OPEC LDC's	−35	−52	−72
Others[2]	−8	−5	−4
Residual[3]	+19	+5	+1
B. Official transfer:			
OPEC	−4	−5	−7
OECD	−18	−22	−27
Non-OPEC LDC's	+13	+16	+18
Others[2]	0	0	0
Residual	+9	+11	+16
C. Current account balances including official transfers:			
OPEC	−7	+62	+117
OECD	+9	−36	−77
Big Seven	(+18)	(−17)	(−39)
Others	(−9)	(−20)	(−39)
Non-OPEC LDC's	−22	−36	−54
Privately financed[4]	(−12)	(−24)	(−39)
Others	(−11)	(−12)	(−15)
Others[2]	−8	−5	−4
Residual	+28	+15	+18

[1] Treasury/IMA staff estimate.
[2] Countries included are Communist bloc (USSR, Bulgaria, Czechoslovakia, East Germany, Hungary, Poland, Romania, Yugoslavia, China) and South Africa.
[3] The residual is the result of two main factors: timing asymmetries in the reporting of exports and imports and, most important, errors and omissions in balance of payments reporting. The positive sign suggests an overreporting of deficits, an underreporting of surpluses or some combination of the two.
[4] Privately financed non-OPEC LDC's are: Argentina, Brazil, Chile, Colombia, Ivory Coast, Korea, Malaysia, Mexico, Morocco, Peru, Philippines, Singapore, Taiwan.

Representative REUSS. Because time is precious and I do have a couple of things on my mind and so does Congressman Richmond and I know Representative Wiley will, let's just start under the 10-minute rule and let's start from this morning's headlines which are the Bonn-Paris, Schmidt-Mitterrand statement that they are going to make the U.S. interest rates a major issue next weekend at Ottawa, as all the world knew. Speaking of them, Chancellor Schmidt is quoted in the German press as having said yesterday, "Ich bin sehr skeptisch." Now you don't have to be a student of German to know that does not mean unqualified enthusiasm for our high interest rate policy, and since you will certainly be advising the President on what kind of an answer he should give when this is thrust upon him, let me just give my scenario of what our friends from Canada, Japan, France, Germany, Italy, and the United Kingdom are going to say.

They are going to say, I should think, "Mr. President, with respect, we are glad that the Federal Reserve is pursuing a policy of controlling the money supply, which we have been urging that for some years, and we think that's good. However, we note with alarm that when you combine a tight control over the money supply—which is what the Federal Reserve is doing—with huge budgetary increases in military expenditures and with huge revenue losses as a result of a very, very massive tax cut program, you

find that those increases in the budget deficit overwhelm the decreases in the deficit made by the cuts in social expenditures, and the necessity of it is, Mr. President, that the Treasury has to go in and borrow in the market and drive up interest rates. Therefore, President Reagan, in the interest of the whole world as well as the United States, would you not consider amending your program so that your military expenditure increase is not as massive and abrupt and that your revenue reduction as a result of the tax program is not as massive and abrupt and, therefore, the Treasury will have to borrow less and interest rates will go down and our problem"—the allies' problem—"of both exchange rates stabilization and of combating domestic unemployment will be greatly eased and the world can go forward happily together."

Now wouldn't such an answer by President Reagan be not only economically right but in accordance with his generally gracious and appealing personality and, hence, wouldn't that be good advice to give the boss?

Mr. RASHISH. Well, I certainly agree on one point. The President has an exceedingly gracious and charming personality.

Representative REUSS. That's 98 percent of it. How about the rest of it?

Mr. RASHISH. I thought that the very articulate, very well-structured and lucid statement that you just made was a statement that you expected to ask Chancellor Schmidt or President Mitterrand to make rather than President Reagan to make.

Representative REUSS. I expected them to make that statement to President Reagan. I'm suggesting to you that a good briefing book for the President would include the possibility of such a demarche.

Mr. RASHISH. Well, we have anticipated that there would be comments, criticisms of that sort directed to U.S. economic policy from principally the continental countries of Europe. In fact, this is a rather interesting process that I get involved in as the sherpa of a preparatory process of the summer. I find probably its greatest value is not so much in preparing for the summit, in sort of a mechanical sense, but it's a replication of what goes on at the summit at a different level and over a longer period of time.

We have engaged in these seven-plus-one—I say "plus-one" because the European—the Commission of European Community has a sherpa as well—that we sherpas over the last 6 months now, since mid-February—that I have been involved in that process—have engaged in the greatest floating intellectual crap game in town covering all these issues, discussing, arguing, debating, and arguing back and forth over a wide range of issues, including obviously the one that has arrested the most—engaged the most interest in not only the newspapers but in the governmental dialogs in various forms, and that's the issue of American economic policy focused principally on interest rates.

To some extent, we sherpas have a certain advantage in that we are all professionals in the game. We are not speaking on the record. Our meetings are closed. There's a high degree of confidentiality. I'm even reluctant to mention the fact that there is such an institution because there hasn't been a leak yet and the minute the press hears about it they will start running stories about what we

say in our quiet deliberations. But we are not obliged to make any statements that have political impact for our respective constituencies and our respective countries, and in the course of almost 6 months of discussion, a good part of it focused on the macroeconomic issue, it is amazing how little in the end disagreement there is, how little criticism has emerged about U.S. policy, how much understanding there is, in fact, that there are in the short term certain costs if you want to pursue an anti-inflation policy that sticks.

Representative REUSS. If I could interrupt you there, since this is on my allotted time, I will concede that in their first formulations the Europeans were clumsy. They asked, "why doesn't the Fed start printing money and lower interest rates?" That was such an easy one to knock out of the ballpark, and it was by Secretary Regan and others. But now Europeans have become much more sophisticated and knowledgeable and what they say specifically is, "No, we aren't telling the United States to change its monetary policy, we're asking the United States to change its mix and not to pursue a fiscal policy—a huge tax cut and huge military expenditure increases—which is sure to bring about budget deficits, Treasury borrowing, and a continued murderous regime of high interest rates."

How should President Reagan answer that?

Mr. RASHISH. Well, if they have a disagreement with monetary policy, which in any case is not conducted by the executive branch of the U.S. Government, and the only complaint that they're likely to have is, as you indicated, against the expenditure-tax mix or fiscal policy—and again reverting to these discussions in the sherpa meetings and the preparatory papers that have been prepared on American economic policy—I have discovered that people are aware of the fact that the United States has the smallest fiscal deficit of percentage of GNP of any of the seven countries and, indeed, several of them are in fact increasing their deficit.

Representative REUSS. Could I interrupt you there? I don't think it will do for the President to say, "You're another." Granted, some of those countries are sloppy, too, in their fiscality, but we are the world leader. The dollar is the world currency. When we sneeze, it infects all of our neighbor countries.

Therefore, I think they'd be justified in their views that the United States has a special obligation to pursue fiscal prudence and not to get into a kind of decadent Keynesianism of the right and have endless deficits which cause interest rates to be so high. So it won't be enough to say, "You're doing it, too."

Mr. RASHISH. Agree, two culpa arguments don't work, but I think it's relevant, however, to observe that if we have a responsibility in respect to the policies we pursue at home not only to the rest of the world—and it's a responsibility we recognize and appreciate—but we also have, I would say primarily, responsibility to our own citizenry and a high interest rate policy, as chafing as it is to others, is equally if not more chafing to the constituent members of our economy.

So that it would be wrong; first, to characterize the level and perhaps the volatility of interest rates as being a product of a conscious policy. Second, I doubt very much whether the small

marginal adjustments that are within the range of political feasibility on the tax expenditure side or the fiscal side would have any consequences to speak of with respect to interest rates, and I think that in greater detail the question of how any deficit is financed is relevant to that, as you yourself admitted; and, finally and perhaps more importantly, in terms of the impact of the high interest rates that do exist on the countries of western Europe who are complaining about them, I think it's fair to say that there have been times in recent history when we have had low interest rates and they have had high interest rates and I suspect that the fact that they have high interest rates today—and vice versa—may have something to do entirely—I shouldn't say entirely—with the economic problems that they presently encounter.

The French have high interest rates today as a matter of public policy to defend the franc against the background of a difficult balance of payments situation. Similarly, the Germans, for their own reasons, have high interest rates as a matter of policy to deal with the particular circumstances that they face.

To be sure, the level of interest rates would not be so high but for the fact that rates are so high here, but to ascribe to the United States interest rates the principal causal role (*a*) with respect to their interest rates; (*b*) with respect to their exchange rates; and (*c*) with respect to the sluggishness of their domestic economy and the constraints on them of pursuing expansive policy, I think is to endow the United States economy with more influence and power than it deserves.

So I think the argument really breaks down on specific points when you examine it in terms of the sort of gross weight of U.S. interest rates as a casual factor in the difficulties that these other countries are pursuing.

There's obviously validity to the proposition that high interest rates in the United States cause high interest rates abroad, but not the levels that exist today abroad and not uniquely and not exclusively, and I don't thing there's much to be done in the case of the fiscal-monetary mix that affects the level of interest rates. I think that's a matter of diagnosis. It's clear that we always insist that interest rates have to be high because of the inflation premium that they reflect, and if inflation rates are high, and more importantly—because interest rates bridge the gap between the present and the future—if expectations with respect to inflation are very high, there is no way in which interest rates are not going to be higher than they would otherwise be in a less inflationary and a less inflation expectational situation.

Representative REUSS. Well, I thought that the administration's program was predicated on the idea that the markets would immediately become happy about the program and hence interest rates would decline. That has not happened, unfortunately. And, a key element of the administration's program—namely, the action of expectations on the market—has not been forthcoming. Since it hasn't, I would hope again—though I see I have not been able to persuade you—that you would at least pass on to the President my earnest hope that he would see fit, both from the standpoint of the economic health of the United States and that of our friends, that we work toward lower interest rates.

To do this we get control over our budget by trimming down on those two elements, military spending increases, and revenue decreases, which now threaten that control. But we have our difference of opinion on that.

Mr. RASHISH. If you take those two blades of the scissors, the expenditure blade and the revenue blade, you certainly don't have any quarrel except for the composition of the expenditures. You have a different sense of priorities, but you don't have any quarrel with the general proposition that the President is committed to keep the expenditure blade as low as possible.

Representative REUSS. I don't have any quarrel with that proposition, but the President does. He's seeing that the military part of the blade isn't part of the cutting process. I went along with the cuts on nonmilitary expenditures. My composition was different, but I went along with that.

Well, my time is up and I think it's been an interesting exchange.

Representative Richmond.

Representative RICHMOND. Thank you, Mr. Chairman.

Mr. Secretary, with the cooperation of my friend and chairman here, Congressman Reuss, and Representative Gillis Long who chairs the Subcommittee on International Trade, Finance, and Security Economics, I have been allowed to hold some very, very interesting hearings on Japanese-American trade relations.

The first witness we had was the Secretary of Commerce, Mr. Baldrige, followed by a panel from the Japan-United States relations group. Our second group was Ambassador Brock, followed by a panel of people who actually were involved in trading with Japan. Yesterday we had our final hearing with Secretary of Agriculture Block, followed by a panel of American agricultural people.

The picture seems to be clear as crystal. This is a totally bipartisan issue. We are finding—as a liberal Democrat Member of Congress, I find myself in total agreement with Messrs. Baldrige, Brock, and Block.

I wonder whether President Reagan and Prime Minister Suzuki could possibly discuss this matter at the Ottawa conference. The parameters I think you must know.

We Americans ship to Japan each year $21 billion worth of nonrenewable natural resources with little or no labor content. That's wheat, corn, copper, and phosphates and timber, the very lifeblood of the United States. The very lifeblood of the United States goes to Japan and, as you know, all of this material is, historically, very low priced. When you talk right now in these days of inflation about corn at $3.60 a bushed, you're talking about something that's historically incredibly cheap.

So, here we're shipping all of these nonrenewable resources out to Japan and, as you know, agricultural products are nonrenewable because they take so much top soil with them every year. We take back $31 billion worth of heavily manufactured, luxury goods, by and large, goods we could comfortably live without, goods which we ourselves in the United States manufacture in competition with Japan. So here we have a $10 billion deficit.

On one side, we have the complete free trade in the United States—not quotas, very low tariffs, no artificial regulations of any

sort whatsoever. On the other side, we have a solid cement wall of quotas, tariffs, and regulations. And then as soon as one barrier of tariffs is reduced, they erect some other kind of artificial regulations, in each and every case.

On the other hand, we have the Japanese Government subsidizing 600,000 farmers because these 600,000 farmers seem to control 140 members of the Japanese Diet, which is the foundation of the Liberal Democrat Party, as against the 109 million consumers who are paying, in some cases, five times too much for their own food.

So what our hearings have been all about is that it would be very, very good for the American worker and consumer and very good for the Japanese consumer if the Japanese would once and for all understand that we ought to not only defend them, but also let us help feed them, thus saving the Japanese consumer an enormous amount of money.

He pays right now between $20 and $30 a pound for beef. With its subsidy on rice, the Japanese Government is paying $2,000 a ton for rice grown in Japan and we can make a profit on it at $400 a ton. Dairy products we can do at 50 percent of their cost.

Somebody testified yesterday that three oranges in Japan offseason cost $6. Well, the same three oranges in our supermarkets sell for well under a dollar, as you know. The difference is mindboggling.

Somebody else testified he could send a shipload of melons or oranges over to Tokyo cheaper than he could send a trainload of that same product to Washington, D.C. We have this incredible capacity to grow food in the United States and if we're going to continue importing all of these unnecessary Japanese goods—television sets and cameras and binoculars and goodness knows how many different games—don't you think the President ought to start mentioning to the Prime Minister that the American people are getting a raw deal out of this—that perhaps something ought to be readjusted? That's one.

The second half of that is their defense posture. I was absolutely furious to read Minister Tanaka's pronouncement in the newspapers a couple days ago. He said that even though Secretary Weinberger and the Japanese Defense Department have some arrangements about the Japanese sharing their laser techniques with our Defense Department, in view of Japan's announced decision to be neutral on defense matters, he's not sure he's going to share their latest technique with Secretary Weinberger. Here they spend 0.09 of 1 percent on defense while they spend 0.04 of 1 percent on business entertaining, and we're spending roughly 8 percent of our GNP on defense. They have a national health insurance program; we don't. They've got a railroad that runs 150 miles per hour and you can set your watch by it; we don't. They subsidize their farmers to the tune of some 500 percent, which is the biggest item in their entire deficit; we don't.

Don't you think the President ought to tell Prime Minister Suzuki that we ought to equalize some of these things and we shouldn't wait until the next round of MTN talks in 1983?

I've given you a lot of statements, Mr. Secretary, but I know you can handle it.

Mr. RASHISH. Your confidence in me exceeds my confidence in myself. But seriously, I think there's a perception, but there are different perceptions that there's some kind of problem with Japan in the world trading system. The Europeans have even more elaborate views on this subject, shall I say, than some I've heard in the United States, and I think it's important to try to sort out some of these things.

I frankly don't agree with much of what you said, by way of preface or preamble material, and I'd be glad to tell you why, but I do agree there's a perception of the problem and that has to be dealt with. But I don't agree, for example, that the fact that so much of our exports to Japan consist of agricultural products or raw materials is in some fashion disadvantageous for the United States. I assume that American farmers are quite happy to sell all that wheat and corn. I don't quite understand what you mean by nonrenewable resources. I assume that food production, particularly field crops, is about as renewable an item as you have.

Representative RICHMOND. No——

Mr. RASHISH. And that there are ways of replacing the nutrients in the soil and so on that may be used up. But then, again, most of our agriculture is consumed at home.

I don't understand what you mean by saying that $31 billion worth of imports from Japan are imports that we can do without. Who's going to make that judgment? I assume the American public makes that judgment when it goes to the store and decides what it wants to buy, and if they decide to buy in the aggregate $31 billion worth of goods from Japan, I assume they do that because it serves their purposes. That's what a free economy is about. Let the consumer judge what he wants to buy.

Now it offends me when the Japanese don't let their own consumers behave the same way, but we're not the losers. They are the losers. And it's stupid for them not to let their consumers buy agricultural products from the United States which we can produce so efficiently and so cheaply when they require their consumers to go to the store and pay x dollars for a pound of beef and so many dollars for a cantaloup, an orange, and so on. It just doesn't make sense to me for economic reasons.

I don't like the idea of continuing to tote up, as so many people do, bilateral balances of trade. I think the world economy is an integrated system and I think that trying to balance off trade accounts on a bilateral basis doesn't make sense for at least two good reasons: Because there are other transactions that go into the accounts besides trade; and, second, if we each tried to adjust our bilateral accounts one against the other, we would end up with zero trade, because the whole process should be to reduce, in a compensatory fashion, all the factors in the game. So it doesn't make any sense.

At the same time, I agree with you that there is a widespread perception, based largely on the fact that the Japanese have been so effective, so skillful, in the adjustment of the most recent oil price shock. Their economy is just a darn sight more resilient than the economies of the other countries of the world, including West Germany, who had considerable success after the 1973–74 shock but is having lots of troubles today. And I think that much of the

present state of annoyance toward Japan has to do with the fact that they do happen to have a resilient and efficient economy and they are making their adjustment.

Now to the extent that there are other factors involved, then there are such things as the fact that the Japan market is alleged to be closed to imports. I suspect that on the level of official restraints at the border, let's say tariffs and quotas, the Japanese are as liberal as anybody. Their average tariff rate is probably as low as the United States and the European Community, and I suspect you will find, except things in selected areas, probably a few quantitative restrictions on imports. But the slow penetration of the Japanese economy by foreigners probably has more to do with the internal distribution system, various types of arrangements, informal guidelines, deep, ingrained prejudice against foreign suppliers, and so on, that don't show up in the form of tariffs and quantitative restrictions, which makes them a lot harder to reach through the process of international negotiation.

That doesn't mean that the Japanese ought not to participate more fully than they have by making greater efforts to reduce these more hidden, nontariff-type of barriers, these distributional constraints and other impediments in an environment that is generally less hospitable to foreign exporters than is the case in the United States, to be sure.

Representative RICHMOND. Mr. Secretary, you're wrong on seven points, but I will wait until my turn comes again to try to straighten you out.

Mr. RASHISH. Perhaps we'll have a chance to hear what your various witnesses before your committee offered in the way of suggestions.

Representative RICHMOND. Your Secretaries of Commerce, Agriculture, and the President's Special Trade Ambassador all agreed 100 percent with my findings. Now you come up here with the absolutely opposite notions, but I can clear them up rather quickly when it comes to my turn to question you again.

Representative REUSS. Mr. Secretary, I turn now to a subject on which I feel very strongly and I may speak with some sharpness about it. That sharpness is in no way directed at you, but you're here as the chief international economics spokesman of the administration and, hence, I must present my disquiet to you.

For 5 years now we have had on the statute books a so-called human rights legislation which—and I quote from it—"proscribes loans by this country to countries that engage in gross violations of internationally recognized human rights, such as torture, cruel or inhumane or degrading treatment or punishment," and enjoins your executive directors of the Inter-American Development Bank and other institutions to oppose any loan to such a country.

And since that has been in effect, our executive directors, some 122 times, have opposed such loans. I happen to think that's a good position on the part of the United States. The institutions, in most cases, have gone ahead and made the loans anyway, but at least we made it clear that we were obeying the mandate of Congress and were not rewarding the torturers and murderers with an "Aye" vote for these international institutions.

Now within the last few days that policy has been abruptly changed. On July 1, a letter was addressed by the administration to the concerned committees—Senate Foreign Relations, House Banking—and those committee chairmen were told that we were going to reverse our policy and were going to vote "Aye" for the Inter-American Development Bank on loans to Argentina, Chile, Paraguay, and Uruguay for things like—I'm reading from the administration's letter of July 1 [1]—private oil and gas credit, refinery conversion, highway, telecommunications, and so on.

All of those countries, as reported by the State Department in its most recent congressionally mandated annual report that was released in March of this year, are still violating human rights. That conclusion is borne out by all of the private agencies—the Red Cross, Amnesty International, and so on.

In Uruguay, for instance, 900 people are still detained as political prisoners at the prison named La Libertad. In Montevideo, conditions are so horrible that when the Red Cross went down there to look at it within the last few weeks the Uruguayan Government wouldn't let them in. In Chile, Amnesty International finds that just this year the incidence of torture and inhumane treatment has increased.

The administration's position is that, in some of these countries, at least there are fewer instances of killings and torturing than there were. Well, after all, after you have killed off most of the dissidents in the country, I would think that that ratio would go down.

So, to me, the administration's act is not only immoral but just plain illegal.

I pass to my second point of difference. That same legislation provides for consultation. It says, "The Secretary of the Treasury shall consult frequently and in a timely manner with the chairmen and ranking minority members of the committees" that I have named "to inform them regarding any prospective changes in policy direction toward countries which have or recently have had poor human rights records."

Well, what happened? Even though the State Department knew perfectly well for 6 months what the findings were with regard to these countries, it waited until July 1, 7 days before the vote on these questions in the Inter-American Development Bank, and then sent a letter to the chairmen involved—Senate Foreign Relations, House Banking—and to the ranking minority members, stating what they were going to do, picking a time when Congress and those particular legislators happened to be out of town because there was a recess of the Congress, known to everybody in Washington and scheduled since early January.

Now in my view, that again is not only immoral but illegal. The consultation was not frequent. It was not timely. And when Congress passed that law it knew what it was doing. In addition to being illegal and immoral, I find the conduct by the administration just plain dumb because the administration is now trying to get the votes of Congressmen on the renewal of these international lending agencies, including the Inter-American Development Bank, a position which I fully support. But surely the administration must

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[1] See letter, p. 29

know that there are a considerable number of Congressmen, mostly of the liberal persuasion, who will vote against these multilateral lending agencies if we divest them of their human rights component.

So I ask you, will the administration reconsider its act of July 1, both in its substantive aspects and in its total disregard of the provision for frequent and timely consultation? I hope you will reconsider and I hope you convey this to your colleagues.

As I said before, I have the distinct impression that you, Mr. Secretary, had very little to do with this, but, after all, you're Under Secretary for Economic Affairs for State and I think I'm justified in addressing this respectful request to you. Could you respond as much as you can?

Mr. RASHISH. I will respond briefly because, as you observed, I did not in fact have much involvement in this. I share, as you know, your passion for human rights and feel indignation whenever any individual's rights are violated.

I did want to ask you a question with respect to the statutory language that was designed to cover the exercise of discretion by the Executive with respect to such matters. Isn't there some language in the law that speaks of patterns of persistent violation, language of that nature?

Representative REUSS. No, not really. And since you're a lawyer and a most excellent one——

Mr. RASHISH. I'm only an economist who parades as a lawyer.

Representative REUSS. I'll show you an excerpt from the law. First of all, it says in section 701 that the U.S. Government shall advance the cause of human rights, including seeking to challenge such countries other than those whose governments engage in a consistent pattern of gross violations of internationally recognized human rights, such as torture or cruel, inhumane or degrading treatment or punishment, prolonged detention without charges or other flagrant denial of life, liberty or person. That's what we were concerned about and it does not say, I emphasize—it does not say—except for those countries which still play fast and loose with human rights but are a little better than they used to be last year. Congress didn't say that. If it had, I would say, "Mr. Haig, Secretary Regan, you're doing fine except for the consultation bit."

Regarding consultation, subsection F, says, "The United States executive director of the institutions listed"—that includes the IDB—"are authorized and instructed to oppose any loan, any extension of financial assistance or any technical assistance to any country described in A(1)(2)"—that's the one we just read.

Then here under subsection 2, it says, "The Secretary of Treasury shall consult frequently and in a timely manner with the chairmen and ranking minority members to inform them regarding any prospective changes in policy direction toward countries who have or recently have had human rights problems."

Let us, by unanimous consent, put an excerpt of that statute in the record.

[The excerpt from Public Law 95-118 follows:]

[Partial text of Public Law 95-118 [H.R. 5262], 91 Stat. 1067, approved October 3, 1977, as amended by Public Law 96-259 [S. 662], 94 Stat. 429 at 431, approved June 3, 1980 [1]]

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TITLE VII—HUMAN RIGHTS

Sec. 701.[2] (a) The United States Government, in connection with its voice and vote in the International Bank for Reconstruction and Development, the International Development Association, the International Finance Corporation, the Inter-American Development Bank, the African Development Fund, and the Asian Development Bank, shall advance the cause of human rights, including by seeking to channel assistance toward countries other than those whose governments engage in—

(1) a consistent pattern of gross violations of internationally recognized human rights, such as torture or cruel, inhumane, or degrading treatment or punishment, prolonged detention without charges, or other flagrant denial to life, liberty, and the security of person; or

(2) provide refuge to individuals committing acts of international terrorism by hijacking aircraft.

(b) Further, the Secretary of the Treasury shall instruct each Executive Director of the above institutions to consider in carrying out his duties.

(1) specific actions by either the executive branch or the Congress as a whole on individual bilateral assistance programs because of human rights considerations;

(2) the extent to which the economic assistance provided by the above institutions directly benefit the needy people in the recipient country;

(3) whether the recipient country has detonated a nuclear device or is not a State Party to the Treaty on Non-Proliferation of Nuclear Weapons or both; and

(4) in relation to assistance for the Socialist Republic of Vietnam, the People's Democratic Republic of Laos, and Democratic Kampuchea (Cambodia), the responsiveness of the governments of such countries in providing a more substantial accounting of Americans missing in action.

(c)(1)[3] The Secretaries of State and Treasury shall report annually to the Speaker of the House of Representatives and the President of the Senate on the progress toward achieving the goals of this title, including the listing required in subsection (d).

(2)[3] (A) The Secretary of the Treasury shall report quarterly on all loans considered by the Boards of Executive Directors of the institutions listed in subsection (a) to the Committee on Banking, Finance and Urban Affairs of the House of Representatives and the Committee on Foreign Relations of the Senate. Each such quarterly report shall include a list of all loans considered by the Boards of Executive Directors of such institutions and shall specify with respect to each such loan—

(i) the institution involved;

(ii) the date of final action;

(iii) the borrower;

(iv) the amount;

(v) the project or program;

(vi) the vote of the United States Government;

(vii) the reason for United States Government opposition, if any;

(viii) the final disposition of the loan; and

(ix) if the United States Government opposed the loan, whether the loan meets basic human needs.

(B) The information required to be reported under subparagraph (A) also shall be included in the annual report to the Congress of the National Advisory Council on International Monetary and Financial Policies.

(d) the United States Government, in connection with its voice and vote in the institutions listed in subsection (a), shall seek to channel assistance to projects which address basic human needs of the people of the recipient country. The annual report required under subsection (c) shall include a listing of categories of such assistance granted, with particular attention to categories that address basic human needs.

(e) In determining whether a country is in gross violation of internationally recognized human rights standards, as defined by the provisions of subsection (a),

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[1] 22 U.S.C. 262c-262g.

[2] 22 U.S.C. 262g.

[3] Paragraph designation "(1)" and a new paragraph (2) were added by Sec. 501(a) of Public Law 96-259 (94 Stat. 431).

the United States Government shall give consideration to the extent of cooperation of such country in permitting an unimpeded investigation of alleged violations of internationally recognized human rights by appropriate international organizations including, but not limited to, the International Committee of the Red Cross, Amnesty International, the International Commission of Jurists, and groups or persons acting under the authority of the United Nations or the Organization of American States.

(f) The United States Executive Directors of the institutions listed in subsection (a) are authorized and instructed to oppose any loan, any extension of financial assistance, or any technical assistance to any country described in subsection (a) (1) or (2), unless such assistance is directed specifically to programs which serve the basic human needs of the citizens of such country.

(g)[4] (1) The Secretary of the Treasury, in consultation with the Secretary of State, shall report quarterly to the chairmen and ranking minority members of the Committee on Banking, Finance and Urban Affairs of the House of Representatives, the subcommittee on International Development Institutions and Finance of such Committee, and the Committee on Foreign Relations of the Senate, in each instance in which the United States Executive Director of an institution listed in subsection (a) opposes any loan, financial assistance, or technical assistance for reasons regarding human rights. Each such report shall include—

(A) the reasons for such opposition;

(B) all policy considerations taken into account in reaching the decision to oppose such loan, financial assistance, or technical assistance;

(C) a description of the human rights conditions in the country involved;

(D) a record of how the United States Government voted on all other loans, financial assistance, and technical assistance to such country during the preceding two years; and

(E) information as to how the decision to oppose such loan, financial assistance, or technical assistance relates to overall United States Government policy on human rights in such country.

(2) The Secretary of the Treasury or his delegate shall consult frequently and in a timely manner with the chairmen and ranking minority members specified in paragraph (1) to inform them regarding any prospective changes in policy direction toward countries which have or recently have had poor human rights records.

Sec. 702. Section 28 of the Inter-American Development Bank Act, as amended (22 U.S.C. 283y), section 211 of the Act of May 31, 1976 (22 U.S.C. 290g–9), and section 15 of the International Development Association Act, as amended (22 U.S.C. 284m), are repealed.

Sec. 703.[5] (a) The Secretary of State and the Secretary of the Treasury shall initiate a wide consultation designed to develop a viable standard for the meeting of basic human needs and the protection of human rights and a mechanism for acting together to insure that the rewards of international economic cooperation are especially available to those who subscribe to such standards and are seen to be moving toward making them effective in their own system of governance.

(b) Not later than one year after the date of enactment of this Act, the Secretary of State and the Secretary of the Treasury shall report to the President of the Senate and the Speaker of the House of Representatives on the progress made in carrying out this section.

Sec. 704. The President shall direct the United States Executive Directors of such international financial institutions to take all appropriate actions to keep the salaries and benefits of the employees of such institutions to levels comparable to salaries and benefits of employees of private business and the United States Government in comparable positions.

Sec. 705.[6] The President shall direct the United States Governor of the International Bank for Reconstruction and Development, the United States Governor of the International Finance Corporation, the United States Governor of the International Development Association, the United States Governor of the Inter-American Development Bank, the United States Governor of the Asian Development Bank, and the United States Governor of the African Development Fund, to consult with the other Governors of those institutions concerning adoption of an amendment to the Arti-

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[4] Subsection (g) was added by Sec. 501(b) of Public Law 96–259 (94 Stat. 432).

[5] 22 U.S.C. 262c note.

[6] 22 U.S.C. 262d note. Sec. 705 was added by Sec. 501(c) of Public Law 96–259 (94 Stat. 432).

cles of Agreement of their respective institutions to establish human rights standards to be considered in connection with each application for assistance.

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Representative REUSS. It seems to me that statute was written by people whose English was pretty good, and they said what they meant. The administration has been playing fast and loose with the law, and it ought to, when it appears before the Foreign Affairs Committee this afternoon, or Thursday, when it appears before the House Banking Committee, confess error and be received back into the company of law abiding citizenry. What do you think?

Mr. RASHISH. Well, I won't comment on the question of timely and frequent consultation by the Secretary of the Treasury or his delegate since that's another department of Government, but the countries under section 701(A)(1), the countries that are beyond the pale, are described as those whose governments engage in a consistent pattern of gross violations of internationally recognized human rights such as torture, cruel, inhumane, degrading treatment or punishment, et cetera.

I guess the judgment here—the statute doesn't make a judgment, does it?

Representative REUSS. Of course.

Mr. RASHISH. It says a consistent pattern of gross violations of internationally recognized human rights, and I guess the judgment necessarily—that language is clear and I certainly agree that the Congress wrote clear language—had to be made as to whether the countries in question, in fact, were engaged in a consistent pattern of gross violations contemporaneously, whatever the historical record may have been. And related to that and in the spirit of the statute, I assume also that, what actions the U.S. Government might take that would encourage these governments to desist—refrain in any violations of the human rights of their citizenry—whether those violations are part of a consistent pattern or whether they are gross. And I suspect, again not having been intimately involved in these decisions but on the fringes of them as I necessarily must be, that what was involved in the decisions with respect to the loans of the IDB—I guess it was only the IDB involved in this particular case?

Representative REUSS. Yes.

Mr. RASHISH. Was the judgment, (*a*) that these countries were not engaged consciously and in a consistent pattern of gross violations of human rights; and (*b*) that while there may be human rights violations, that the way in which to get these countries to moderate, to ameliorate, to completely remove—I make no distinction between small human rights violations and large ones personally—but any violation of human rights, that it would not be an effective technique for inducing them to abandon any violation of human rights by denying them access to the resources of this institution, even recognizing that the United States by its vote was unlikely to be able to deny them access to these resources in any case. That is to say, the vote was not one which we controlled. We do not veto the other countries.

I think all of those elements enter into the picture and I hope in the considerations or discussions you have with the officials of the U.S. Government who were more intimately involved in this decision than I, that you will be satisfied that the President or his

administration does not condone, support or countenance or approve of, in any fashion, the violation of human rights in any way.

Representative REUSS. I'm not so satisfied, frankly, because I have before me and will submit for the record at the end of this colloquy the State Department's—that's your department—report on the conditions of human rights in Argentina, Chile, Paraguay, and Uruguay published in March of 1981.

That's an annual report, and is mandated by Congress; it fairly bristles with indications of gross violations of human rights.

In Paraguay, for instance, the State Department's statement says the Paraguay police are reliably reported to mistreat prisoners during the early stages of detention. This includes beatings, forced standing for long periods of time, withholding of food, lengthy isolation, and threats against detainees and their families. It goes on and on. It says that in some of these countries it's better, but I repeat again, there isn't one syllable in that statute that says that a country which impairs human rights and grossly violates them is home free just because it doesn't grossly violate them quite as grossly as it did the year before.

So here is the State Department's own findings. Those by Amnesty International and the International Red Cross are even more devastating.

In what document did the State Department, as of July 1, renege on its congressionally mandated annual report which was published 3 months before in March? Where is the new findings which say all of these countries are now nonviolators of human rights?

Mr. RASHISH. The findings in that document which you referred to are not informed by the same statutory standard as applies in connection with the international financial institutions.

Representative REUSS. That's correct.

Mr. RASHISH. It's one thing to find that there are violations of human rights and the people's rights are abused in countries in various measures depending on the country; it's another thing to make a determination that a given country consistent with the statute, section 701, has engaged in or does engage in a consistent pattern of gross violations. So I can see a difference between the two.

We don't condone the violations of human rights. In fact, we bring those to light in the publication which you mentioned. It's another matter and another standard to be applied in determining whether the U.S. executive director of an international financial institution shall vote "No" on a loan application of a particular country, that vote being determined by these criteria that's set out in the statute—two, I think, separate issues of law.

Representative REUSS. Well, my time is up, but I would renew my request that you ask the administration to abandon its July 1, 1981, policy and to obey the law just like anybody else. I think they are violating it.

[The Department of the Treasury letter, together with attachments, referred to by Representative Reuss follows:]

DEPARTMENT OF THE TREASURY,
Washington, D.C., July 1, 1981.

Hon. JERRY PATTERSON,
Chairman, Subcommittee on International Development Institutions and Finance, Committee on Banking, Finance, and Urban Affairs, U.S. House of Representatives.

DEAR MR. CHAIRMAN: In accordance with the provisions of Title V (Human Rights Reporting) of Public Law 96-259 enacted on June 3, 1980, I would like to inform you of a prospective change in our voting policy on multilateral development bank (MDB) loans to Argentina, Chile, Paraguay and Uruguay. On the basis of human rights considerations, the United States has been opposing by abstention non-basic human needs MDB loans to Argentina, Paraguay and Uruguay. In the case of Chile, the United States has been voting "no" on all loans based on human rights considerations and concern about Chile's handling of the Letelier matter.

During the month of July, the following non-basic human needs loans are scheduled for MDB Board consideration:

Argentina

July 7: IBRD $100 million, Private Oil and Gas Credit.
July 7: IBRD $200 million, Refinery Conversion.
July 21: IFC $10 million, IPAKO III.

Chile

July 8: IDB $126 million, Highway.

Paraguay

July 14: IFC $7.8 million, Golondrina S.A.

Uruguay

July 7: IBRD $40.0 million, Telecommunications.

The Department of State has reviewed the current human rights situation in Argentina, Chile, Paraguay and Uruguay and has determined that the human rights legislation enacted in 1977 (P.L. 95-118) does not require U.S. opposition to MDB loans to these countries. Since there are no other reasons to oppose these loans, it is the Treasury Department's intention to instruct our representatives at the World Bank and the Inter-American Development Bank to support the loans when they are considered by the Boards. In his discussions with the governments of Argentina, Chile, Paraguay and Uruguay, the Department of State will explain the reasons for the change in vote and urge that the governments continue their efforts to improve the overall human rights situation in their respective countries.

I will be happy to provide you with any additional information you may require on the upcoming loans.

Sincerely,

W. DENNIS THOMAS,
Assistant Secretary, Legislative Affairs.

Attachments.

URUGUAY

There were some improvements in the human rights situation in Uruguay in 1980, following eight years of stringent controls over individual and political rights. Although many features of the post-1973 authoritarian system remain in place, the country has begun a process of broader political participation.

Until the early 1970's, Uruguay had long been a democracy with advanced social welfare policies. However, in the mid-60's, a period of national malaise reflecting two decades of economic stagnation culminated in severe urban terrorism by the Marxist-oriented Tupamaros. Civil institutions had great difficulty coping with this challenge. In reaction to these developments, the elected civilian government in 1972 passed a national security law. This law and subsequent legislation suspended or curbed individual liberties, expanded police and military powers and shifted national security cases to military court.

Conflict between the legislative branch and the armed forces over the conduct of the anti-terrorism campaign (which included disappearances, torture and arbitrary arrests), led to the closure of the congress in June 1973. The trend thereafter was toward de facto military rule. The constitutionally-elected president was removed by the military in June 1976, and replaced by another civilian. Since then the armed forces, through a series of institutional decrees, have exercised control over the "civil-military" government.

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With democratic institutions largely suspended, anti-terrorist activities were conducted with little regard for individual rights. The 1971–73 campaign against the Tupamaros resulted in their virtual elimination. A second wave of security arrests, from 1975 through mid-1977, concentrated on communists and far-left activists, many of whom appear to have been arrested for participating in political activities which were legal when carried out. Other arrests, including members of labor, media, university and professional groups had little or no apparent connection with politics.

The period from 1975 to 1979 was marked by suppression of political activities, de facto suspensions of political parties, proscription of hundreds of democratic political leaders, severe restrictions of freedom of expression, loss of independence of the judiciary, and intimidation of the legal profession. There were large numbers of detentions on political grounds. Torture and other forms of mistreatment of political detainees occurred during interrogation.

Since 1978 there have been improvements in human rights observance. This trend accelerated in 1980. There has been a continued decline in violations of the integrity of the person. The number of substantial reports of new political arrests and instances of prisoner mistreatment has been reduced. New detainees have been processed more rapidly, with most released within days. The gradual release of political prisoners, coupled with a relatively low number of new indictments, brought the number of political detainees to some 1,219 on December 1, 1980. Of the 1,219 detainees, at least 300 have been convicted of violent crimes.

The government has continued during 1980 to pursue an economic policy of austerity and reform designed to provide a stronger and more efficient economy. Recent years have seen structural improvements and rapid economic growth, after several decades of stagnation. Despite growth and the array of available social services, lower income groups, with incomes eroded by inflation and austerity measures, have been seriously affected.

In 1980 the government began to implement major elements of its August 1977 political plan to restore constitutional order. While most leading politicians remain proscribed, or legally barred from political activity, some lesser figures have had their political rights restored.

The government submitted a proposed new constitution to a plebiscite November 30, 1980. During the period just prior to the plebiscite there was extensive public debate and an upsurge in party activity. In a democratic vote, with full electoral guarantees, Uruguayan voters rejected the proposed constitution which provided for a major continuing role for the military in government. As a result of this action, the government voided the 1977 political plan and has begun to consider the nature and possible form of new measures to govern the political opening in Uruguay. Its new program is expected to be announced during 1981.

1. RESPECT FOR THE INTEGRITY OF THE PERSON, INCLUDING FREEDOM FROM

a. Torture

During the period from 1972 to 1977, torture was used extensively to obtain information or confessions from suspected Tupamaro terrorists, and later from communists, leftists, and other political opponents. Methods used included electric shock, severe beatings and immersion of the head in water. Fewer reports were received in 1978 and 1979. In 1979, Uruguayan authorities took internal measures to curb the use of torture.

During 1980 there were occasional credible reports (fewer than in 1979) from victims, relatives and others of physical and psychological mistreatment during interrogation. No one has been apprehended or punished for torture.

b. Cruel, inhuman or degrading treatment or punishment

The death penalty and brutal treatment are outlawed by Article 26 of the constitution of 1967. Intimidation and psychological abuse of detainees occurred in 1980 but are *less common than in the past,* evidencing military curbs on such abuses. However, very harsh treatment still may occur during the initial period of detention for interrogation when prisoners are held incommunicado. Such treatment may consist of beatings, lack of food and/or water, isolation, hooding for extended periods, or deprivation of sleep. Both the police and the military handle initial processing of prisoners, and the kind of treatment is often determined by the type of charges, the prominence of the individual involved, and the unit handling the case.

After indictment, almost all prisoners are confined in official detention facilities, with conditions for political detainees somewhat better than for common criminals. Prisoners are not normally mistreated at this stage, although during 1980 there were some credible reports of abuse of prisoners by guards and other prisoners in Libertad prison. Health care and diet appear to be adequate. Prisoners are permit-

ted to see visitors every two weeks under restricted conditions and to receive parcels and funds for canteen purchases. During the first half of 1980, the International Committee of the Red Cross visited virtually all political detainees in Uruguay. An official of the Anti-Defamation League of B'nai B'rith also visited 40 political prisoners in two principal prisons.

c. Disappearances

Since 1978, there have been no reports of disappearance. A number of reported disappearances from earlier years have not been resolved. The practice of not informing families of arrest, whereabouts and health of prisoners detained for security reasons often continues. All such recent cases have been resolved once the authorities completed initial investigations and indicted or released the individual. The notification period for families and defense counsel has been successively reduced each year since 1978.

d. Arbitrary arrest and imprisonment

Habeas corpus and other constitutional guarantees against arbitrary detention have been effectively suspended in security cases. Uruguayan authorities insist that there are no "political prisoners", and that all "national security prisoners" were arrested for violent or common crimes or for subversive activities. However, the definition of subversive activity has been expanded to include offenses such as "undermining the morale of the armed forces" and disrespect to military authorities.

Government statistics indicate that in the period since April 1972 approximately 6,000 persons have been turned over to the military justice system. Over 1,300 were subsequently released without trial, and approximately 3,500 others freed by judicial order for various reasons, many of them conditionally. There were an estimated 1,500 prisoners under jurisdiction of the military justice system at the end of 1979 (either awaiting completion of trials or serving sentences) plus some 200 new detentions this year. Subsequent releases have reduced the number to about 1,219 as of December 1, 1980. A small number of persons, fewer than 50 at any given time, may be detained without formal charges under emergency security measures. Although the total figure is somewhat lower than the 1,500 prisoners of conscience and other political prisoners estimated by Amnesty International in its 1980 report, there is significant independent evidence to support the Uruguayan government's figures. Of the 1,219 prisoners held, a certain number, once estimated by military authorities at about 300, have been convicted of violent crimes, and many others of lesser but related offenses. However, in the absence of adequate guarantees in the military trial system, it is questionable that all those convicted received fair trials.

The military penal code permits a prisoner to be held for as long as 10 days before being presented to a military judge. The ordinary penal code requires filing a charge within 24 hours and initiation of proceedings within 48 hours. In practice, longer delays before indictment have been experienced in both systems.

e. Denial of Fair Public Trial

Under both the ordinary and military codes the Uruguayan court system relies on written proceedings in pretrial investigation, indictment, trial and sentencing. Terrorism, subversion, non-violent political offenses and other "crimes against the nation" are subject to adjudication under the military code. Confessions, sometimes obtained under severe physical and psychological pressure, remain the basis for most convictions. The judge, civil or military, decides on the basis of written briefs, and often confronts the accused only during arraignment and when sentencing. Cross-examination is a written procedure conducted through the judge. The evidence, arguments, and records are normally closed to the public and the press. However, the military appeals process provides for a public hearing in open court. During 1979 and 1980, the authorities have permitted and even encouraged media coverage of certain cases.

The military justice system remains secret and arbitrary, seriously limiting the rights and ability of the accused to mount an effective defense. Standards governing admissibility of evidence, especially confessional evidence, are less rigorous under the military than the ordinary penal code. Attorneys under the military code have little opportunity for an effective defense. Decisions of the military court system may be appealed to as high as the supreme court, although this appeals process is rarely used.

Since 1978, Uruguyan authorities have sought to speed the work of the military court system, reducing the number of new cases involving significant pre-indictment delay. Accelerated processing of cases has reportedly reduced the total of prisoners awaiting indictment to about 100, and has permitted many to be granted release in a matter of days. The number of cases awaiting sentence in courts of first instance

has declined from 400 in late 1979 to about 100. During 1980, the supreme military tribunal reviewed 230 appeals cases, involving 707 defendants. Nonetheless, the system is still characterized by backlogs and administrative inefficiencies which delay processing and consideration of the mandatory second instance appeals of all sentences of more than three years.

The Inter-American Human Rights Commission in its 1980 report on Uruguay warns that the military judicial system still does not guarantee due process.

Detainees are free to choose their own counsel, but find few civilian lawyers willing to plead cases before military courts. They therefore generally have to choose a court-appointed public defender, who may be a civilian attorney or a military officer familiar with courts martial procedure. Amnesty International and the International Commission of Jurists report that most prisoners have had a military officer without legal training appointed by the state as defense counsel. Counsel does not have access to clients prior to indictment. Recently, earlier indictment has allowed more rapid access by prisoners to counsel. Once the accused is indicted under the military code, counsel may see clients only in the presence of the authorities. They may see them in private under the ordinary code. Counsel does not have full access to evidence under the military code. Defense counsels are limited by the system largely to sentence-bargaining and pleading for early release. There are no known cases where an accused subversive, once indicted, has been acquitted under the military penal code.

Approximately 500 prisoners were released in 1977, 600 more in 1978, another 600 during 1979, and an estimated 330 in 1980. Most were freed under a variety of parole programs. A prisoner on parole may be denied the right to travel, may experience difficulty in finding work and is subject to rearrest for parole violation. Persons detained under the military justice system sometimes continue to be held under emergency security measures, or are rearrested on new charges after completing their sentences.

f. Invasion of the home

Guarantees of inviolability of the home of persons suspected of terrorism, subversion or other crimes against the nation are suspended under the current emergency security measures but are still respected in non-security cases. Invasions of homes by security forces have been infrequent from 1978 to 1980. There are credible reports of telephone eavesdropping by security units.

2. GOVERNMENT POLICIES RELATING TO THE FULFILLMENT OF SUCH VITAL NEEDS AS FOOD, SHELTER, HEALTH CARE AND EDUCATION

The government is following policies designed to change Uruguay from a closed, inward-looking, highly protectionist public sector dominated and stagnant economy into a more open, free and competitive economy capable of self-sustained growth. The picture is now one of steady recuperation from the economic woes of the sixties and seventies when per capita incomes declined, capital was run down, balance of payments problems were chronic and inflation reached unprecedented levels. The gross national product (GNP) increased an estimated six percent in 1980. Annual per capita GNP growth averaged 5.2 percent in the period 1975–79, while in the periods 1965–70 and 1970–75 it had been only 1.4 percent and 0.9 percent respectively.

Development efforts have focused on increasing investment in agriculture and industry, where stagnation had made it impossible to sustain income levels and social programs. The population is well-fed (the calorie supply in 1978 was 114 percent of individual requirement). There are government-sponsored social assistance programs for the poor and housing programs for middle and lower income groups. The right of private property is well-established and protected. Low mortality rates (infant morality is only 49 per thousand) and an average life expectancy of 71 years, one of the highest in Latin America, are the result of widespread availability of health care, free or at nominal cost. Free public education through the university level is available to all, although during 1980, university entrance examinations were required for the first time. The adult literacy rate is 94 percent. Per capita GNP in 1979 was equivalent to $2,090 (1979 dollars), one of the highest in Latin America. Employment percentages and hours worked have reached record high levels in 1980. However, the high inflation rate (83 percent in 1979 and an annual rate of over 55 percent during the first eight months of 1980) continues to reduce the purchasing power of some consumers, especially those on fixed incomes or in the lower wage brackets, including rural workers. The government policy of increasing investment while reducing government operating expenses, subsidies, protection and holding down wage increases has led to a decline in real wages,

although the effects were offset somewhat by relatively low unemployment (6.7 percent according to government data) and increased hours worked.

3. RESPECT FOR CIVIL AND POLITICAL LIBERTIES, INCLUDING

a. Freedom of Speech, Press, Religion and Assembly

The press, radio, television and publishing industries continue to be restricted. They operate under a system of self-censorship, monitored by the National Office of Public Relations (DINARP). Under the emergency security measures, no discussion of the government's anti-subversive activities is permitted beyond official releases. No unfavorable comment on the armed forces is tolerated.

There was a notable increase in media freedom during late 1980, with extensive public discussion and criticism on the government-proposed constitution, both in print and on radio and television. Journalists became increasingly bold in questioning government officials and in expressing opposition to government policy in many areas. At the same time, there were continued counter pressures in the other direction. The editor of a leading monthly magazine was held for eight days; a radio news commentator was detained and harrassed for critical comments on non-political subjects; and several of Uruguay's foremost journalists resigned under pressure after disputes concerning publication of controversial material. The government's power to dispense advertising and DINARP's authority to monitor and interpret the self-censorship program continued to impose a restriction on media freedom. Most recently, the government has banned reporting on political party activities.

Foreign publications from non-communist countries are freely available in Uruguay, although there were two reported instances in 1980 when an issue of a foreign weekly news magazine was prevented from appearing.

The exercise of the right of public assembly, although controlled, improved during 1980, especially during the debate on the constitution. During the year, the government began to permit public meetings of a political nature, which allowed the two traditional political parties to expand their activities. A large number of political rallies held by opposition groups during the period preceding the November plebiscite. Non-political gatherings are generally conducted without interference.

Labor unions do not have effective rights to organize, negotiate, or strike. The labor movement was virtually dissolved in 1973. In 1978, the government began informally to relax some of the constraints on organizing and bargaining, and democratic trade unions and their national confederation began to revive. Although the government has prepared legislation to permit expanded labor activity, the law has not yet been enacted. The government continues to consult with the International Labor Organization (ILO) on this and other matters related to improving the situation of organized labor. Authorities continued during 1980 to allow limited organizational and collective bargaining activities, although at mid-year there were several instances of reprisals taken by employers against the officers of newly-formed unions, and union leaders complained of government harassment at different times during the late spring and summer.

Uruguay is a secular state; religious freedom is constitutionally guaranteed and respected. There have been several indications during the year of government concern over the activities of liberal church-affiliated groups, but differences were resolved without incident. Jewish community leaders have pressed the authorities to be more aggressive in responding to occasional instances of anti-semitism.

b. Freedom of movement within the country, foreign travel, emigration and repatriation

There are no general restrictions on freedom of movement within Uruguay, foreign travel, or emigration. However, the government sometimes delays response or denies such rights as the renewal of passports in cases of persons suspected of past or present "undesirable association". The government has normally denied to political prisoners the option to depart the country rather than serve a prison sentence. During 1980, twelve dual-nationals imprisoned for political offenses were paroled and allowed to return to their foreign homelands. The last known case of forcible repatriation was in 1978.

c. Freedom to participate in the political process

During the first months of 1980, there was no popular participation in the political process, and there were no popularly-elected, national government officials. Since that time, the government has permitted a marked increase in political participation, particularly related to consideration of a new draft constitution on which a plebiscite was held on November 30, 1980. During that period there was extensive party and public political activity of all forms.

A majority of Uruguayans rejected the proposed new constitution which was to be followed in 1981 by return to active status of the traditional parties and the selection of a new president and congressional elections. Some political leaders had criticized the nature, timetable and structure of the political opening. Government leaders announced that the transition to democracy would continue and a new program is expected to be announced during 1981.

Restrictions on civil and political rights, applicable principally to leftist political groupings in the former Frente Amplio, still extend to thousands. The government has reviewed the cases of 468 proscribed politicians, primarily members of the two major traditional political parties, while ignoring political activitists of the left. Of the cases reviewed, 150 had their proscriptions lifted by the end of 1979. During 1980, proscriptions were lifted on an additional 84 individuals, only a few of whom had played a major political role, leaving the number of proscribed politicians of the Colorado and Blanco parties at approximately 230, including all major political leaders.

The rebuilding of the traditional Colorado, Blanco and Radical Christian parties was allowed to begin in 1980. Party "provisional commissions" were formed, intended to be representative of the proscribed leadership, and the first official contacts since 1973 between the government and representatives of the parties took place at the end of August 1980. However, control of Colorado Party assets was removed from the existing party leadership in 1980 through restructuring of the party's "administrative commission".

During 1980, the government used Institutional Act No. 7 to dismiss several dozen employees for participation in activities of the traditional parties. In addition, the government continued to dismiss permanently tenured government employees suspected of subversive political beliefs under the Act, although on a diminished scale. Several thousand persons have been fired since July 1977, many from the education system. Those retained are expected to execute a loyalty oath.

Women in Uruguay are accorded equality before the law. They attend the university and pursue professional careers in large numbers. Women are scarce on the political scene, and few women currently hold high government office. Those who do hold high government office tend to occupy positions related to child care, education, social welfare, or family affairs. Traditional social patterns restrict employment opportunity for women in some cases, and equality of pay is not always granted.

4. GOVERNMENT ATTITUDE AND RECORD REGARDING INTERNATIONAL AND NON-GOVERNMENTAL INVESTIGATION OF ALLEGED VIOLATIONS OF HUMAN RIGHTS

Uruguayan government attitudes toward investigation of alleged human rights violations have varied considerably over time. It has responded to inquiries made in the United Nations Human Rights Commission, which is considering the human rights situation in Uruguay under its confidential 1503 procedures. Uruguay continues to cooperate with the ILO regarding trade union practices. However, the government still opposes the scheduling of a visit requested by the Inter-American Human Rights Commission. Contact was resumed in 1979 with the International Committee of the Red Cross (ICRC) concerning renewal of its activities on behalf of prisoners. An ICRC delegation visited virtually all political detainees in early 1980 and submitted a report to the Uruguayan government.

Other organizations such as the National Academy of Sciences and B'nai B'rith, maintained dialogues with the Uruguayan government. The Latin American director of the Anti-Defamation League visited Uruguay at the invitation of the government in May when he met with authorities and interviewed 40 political detainees in the two principal prisons. Responsiveness to the concerns expressed in April 1978 by the American Bar Association mission continues to be shown by the government in administering the military justice system.

There are no non-governmental human rights organizations in Uruguay.

U.S. OVERSEAS—LOANS AND GRANTS—OBLIGATIONS AND LOAN AUTHORIZATIONS

[U.S. fiscal years—millions of dollars]

	1978	1979	1980	1946–80
Country: Uruguay:				
I. Econ. assist.—Total	0.2	0.2	0.0	.....
Loans	0	0	0	.....
Grants	.2	.2	0	.....
A. AID	0	0	0	.....

U.S. OVERSEAS—LOANS AND GRANTS—OBLIGATIONS AND LOAN AUTHORIZATIONS—Continued

[U.S. fiscal years—millions of dollars]

	1978	1979	1980	1946–80
Loans	0	0	0	.....
Grants	0	0	0	.....
(Sec. supp. assist.)	0	0	0	.....
B. Food for Peace	0	0	0	.....
Loans	0	0	0	.....
Grants	0	0	0	.....
Title I—Total	0	0	0	.....
Repay. in dollars-loans	0	0	0	.....
Pay. in for. curr	0	0	0	.....
Title II—Total	0	0	0	.....
E. Relief ec. dev. & WFP	0	0	0	.....
Vol. relief agency	0	0	0	.....
C. Other econ. assist	.2	.2	0	.....
Loans	0	0	0	.....
Grants	.2	.2	0	.....
Contr. to IFI	0	0	0	.....
Peace Corps	0	0	0	.....
Other	.2	.2	0	.....
II. Mil. assist.—Total	0	0	0	.....
Loans	0	0	0	.....
Grants	0	0	0	.....
A. Map grants	0	0	0	.....
B. Credit sales—FMS	0	0	0	.....
C. Intl. mil. ed. trng	0	0	0	.....
D. Tran-excess stock	0	0	0	.....
E. Other grants	0	0	0	.....
III. Total econ. & mil	.2	.2	0	.....
Loans	0	0	0	.....
Grants	.2	.2	0	.....
Other U.S. loans	0	0	0	.....
Ex-Im bank loans	0	0	0	.....
All other	0	0	0	.....
Assistance from international agencies: Total	43.2	70.3	168.5	632.3
IBRD	9.7	26.5	98.0	327.2
IFC	0	6.4	10.7	20.8
IDA	0	0	0	0
IDB	32.4	35.7	57.5	262.1
ADB	0	0	0	0
AFDB	0	0	0	0
UNDP	1.1	1.7	2.3	21.3
Other—UN	0	0	0	.9
EEC	0	0	0	0

VENEZUELA

In twenty-two years of uninterrupted democratic experience, Venezuela has developed into a free and pluralistic society with the resiliency to adapt to enormous social changes, including a doubling of the population and massive migration to the cities which has transformed an essentially rural nation into one that is nearly 80 percent urban. Until the late 1960's, the country also had a serious guerrilla problem. Venezuela has repeatedly demonstrated its ability to effect a peaceful transfer of power between opposing political parties, and electoral politics is the accepted norm at all levels of the society. Contentiousness has been accommodated with the insitutionalization of democracy, and Venezula maintains a clear commitment to human rights and a good record in practice.

One of the most active promoters of democracy and human rights in the hemisphere, Venezuela has strongly welcomed international initiatives on human rights. It was an active supporter of the return to democracy in Peru and Ecuador, as well

as of the aborted democratic effort in Bolivia. Venezuelan assistance programs are largely directed toward alleviating the economic problems of the oil poor democracies in the region.

The Venezuelan enjoys a high degree of individual liberty. His rights are protected by a judiciary which enforces habeas corpus, a free press with a history of attention to possible human rights abuses, and an open political system which features constant competition for public attention on social issues.

Successive democratic governments have pursued effective policies to co-opt politically motivated advocates of violence into the legitimate political process. They have done this with such success over the years that the president of Venezuela's third largest party is a former guerrilla who accepted the proffered opportunity to renounce violence for legitimate politics. President Luis Herrera Campins' amnesty program was the culmination of this process. Prominent former guerrilla leaders who had been imprisoned or living underground accepted the amnesty offer, although a few have rejected it. With the implementation of this amnesty, foreign observers, such as the Council on Hemispheric Affairs, have concluded that former political activists remaining in jail have been found guilty of criminal offenses and are not political prisoners or prisoners of conscience.

Venezuela is South America's largest petroleum producer, and oil wealth accounts for a per capita gross national product (GNP) of approximately $3600. Nationalized oil and other industries, although administered like private enterprises, place a substantial proportion of national resources under direct or indirect government control, and an estimated one fourth of national employment is in government or antonomous government enterprises. Despite relatively high employment, income distribution patterns are unfavorable at the lower end of the economic scale. Approximately 70 percent of the work force has only primary education or less. Much remains to be done before the poorer sections of society have economic opportunities that match their political liberties.

Central and South America

Argentina

For the past 25 years Argentina has experienced cyclical changes between civilian and military governments. Since 1955 there have been six civilian and six military presidents. Beginning in 1969, violence mounted steadily from the left and then from the right as groups with widely different political objectives and conceptions struggled for power. As a result of this violence and instability, both civilian and military governments have maintained a state of siege for some ten of the pas. eleven years.

At the time the military took control of the state in 1976, the situation in Agrentina had deteriorated sharply. Courts and political leaders were intimidated, inflation approached 800 percent, and many essential public services were disrupted. Terrorism had taken on broad dimensions; bombings, robberies, kidnappings and assassinations for political reasons were common occurrences. Organized terrorist groups on both sides of the political spectrum numbered some 5,000–6,000 persons, with sympathizers estimated at an additional 15,000. The new government promised to restore stability, promote economic recovery, end terrorism and corruption, and ultimately to restore democracy. Maintaining the state of siege imposed in 1974 by President Maria Estela Peron, the armed forces closed congress, deposed the president, and replaced all members of the supreme court. Elected state and local government officials were replaced by military officers, and political party activities, including the right of assembly, were prohibited. Most trade unions were subjected to government intervention, and all strikes were banned. The security forces embarked on a widespread campaign of violence aimed at terrorists as well as those elements of society they considered subversive. Many known or suspected terrorists, as well as many persons with no subversive record, disappeared. Many others were detained by the executive without any specific charge under the state of siege powers of the constitution. In 1978 spokesmen for the government announced that the war on terrorism had been won. The diminished threat from violence of the left and right, the government's own initiatives toward bettering the human rights situation, and its increasing awareness of international concern over Argentina's human rights image have contributed to a reduction in the number of violations.

The human rights situation in Argentina improved in 1980, although serious problems remained. Most seriously, fundamental, internationally-recognized rights of the integrity of the person have been violated through the continued application by the security forces of the practice of disappearances, although at a level much lower than occurred in the first two years of the present military regime. In 1980, there were 28 of more reported disappearances; at least 12 have been credibly

documented. Most observers believe torture and summary execution continue to be practiced in these cases.

The most carefully recorded and documented list of unexplained disappearances, compiled by the Permanent Assembly for Human Rights in Buenos Aires, contains about 5,600 cases for the period 1976 to 1979. Some estimates, however, run considerably higher. There is substantial evidence that most of those persons were abducted by the security forces and interrogated under torture. Many observers believe these persons have been summarily executed. There has been no accounting for past disappearances.

About 8,200 persons have been detained since 1974 under the special executive powers of the president (PEN). This number has been reduced. In December 1980 the government acknowleged that approximately 900 persons remain under PEN detention. Including these prisoners, the total number of persons being held on other than criminal charges totaled about 1,550. Of these, about 600 had been tried and convicted, another 400 were in trial status, and about 550 were being held without trial and/or charges, some for many years or even afer having served their sentences. Government figures indicate that this year eight new arrests were made under the executive's special powers and 888 persons were removed from PEN detention. There continue to be reliable reports that individuals detained as suspected terrorists or subversives are subject to physicial mistreatment during interrogation.

The constitutional right of certain kinds of detainees to choose self-exile in lieu of imprisonment has been circumscribed through the imposition of a lengthy application and screening process. Prison conditions have improved. Earlier problem of serious mistreatment, overcrowding, lack of medical treatment, improper food, and restrictions on visits have diminished. However, there is still concern over psychological pressures in the prisons which may have contributed to some five suicides this year.

In September 1979, the Inter-American Human Rights Commission (IAHRC) visited Argentina to investigate human rights abuses. Its 266 page report, published in April 1980, documented serious violations of human rights during the period covered by the report (1975–1979), and recommended that specific actions be taken by the Argentina government to promote the observance of human rights. The Argentine government took exception to aspects of the report; at the same time it reported to the Organization of American States (OAS) the actions it has taken or intends to take to carry out many of the report's recommendations. A resolution referring to this report as well as to other IAHRC reports was adopted by consensus after a prolonged debate at the November OAS General Assembly.

Opportunities for the exercise of political freedoms remain circumscribed by the prohibition on political party activities, as such, and by limitations on freedom of expression. However, a dialogue with many of the nation's political leaders aimed ultimately at removing these retrictions was begun by the government. Politicans and the press spoke out increasingly on the government's actions and plans, and public dissent from the government's decisions and open criticism of its policies and programs, including the statements and activities of opposition leaders, were reported regularly in the press. Increasingly, civilian leaders organized meetings and conferences to consider national issues. At the same time, politicians were occasionally detained on the grounds that they had overstepped the limits of the law. The new political parties law, which the government had promised to issue this year, is now expected in 1981. The military designated a new military president for the period 1981–1984, while reiterating its commitment to return the country to civilian, democratic rule. However, as of the end of 1980, no date has been fixed for that devolution.

The 1980 Nobel Peace Prize was awarded to Adolfo Perez Esquivel, Secretary of the Peace and Justice Movement, for his non-violent advocacy of human rights in Argentina and elsewhere in Latin America, He was imprisoned in 1977–1978 for his activities.

1. RESPECT FOR THE INTEGRITY OF THE PERSON, INCLUDING FREEDOM FROM

a, Torture

Article 20 of the Argentine constitution prohibits torture. Most observers have concluded that torture continues to be practiced in the cases of individuals who disappear at the hands of security officials, and are presumed dead. Former detainees have reported that torture, practiced during the first days of the interrogation, took the form of electric shock, immersion of the head in water, mock executions, severe beatings, and psychological abuse. Reports from some people detained for national security reasons during 1980 indicated that physical mistreatment continues to be used during the interrogation phase.

b. Cruel, inhuman or degrading treatment or punishment

Before early 1979, conditions or imprisonment for those detained for security reasons were poor and medical services were rudimentary. In April 1979, the government decreed uniform prison regulations which have led to a general improvement in prison conditions for most categories of prisoners. Many of the reforms were not applied to all prisoners, in particular those detained for political reasons and considered by the authorities to be subversive or dangerous. While conditions reportedly improved for this category for a time after the issuance of the decree, they again deteriorated thereafter. Many of these prisoners were denied visitation, communication, exercise, and work. In May 1980, a new decree was issued which was designed to reduce abuses and disciplinary measures by prison guards, improve medical care and provide increased family visits, visits by counsel, and access to reading material, work and exercise. Initial reports suggest there has been improvement in these areas. However, concern remains about psychological pressures affecting prisoners, in view of the approximately five suicides this year.

c. Disappearances

The Argentine Permanent Assembly on Human Rights has recorded twelve reports of disappearances in circumstances which indicate the victim was abducted by the security forces. Human rights organizations allege that a larger number of people disappeared—perhaps 28 or more. Most Argentine observers believe that many of those who disappeared had active links to terrorist organizations. There were also cases of suspected terrorists being placed before the courts when, in the past, they might simply have disappeared. Two people who reportedly disappeared in 1980 were Paraguayan communists living clandestinely as refugees in Argentina.

Amnesty International and other human rights organizations charge that Argentine security forces participated in a widely publicized disappearance in June 1980 of four Argentines in Lima, Peru. The Argentine government has denied any role in their disappearance.

The authorities have not yet accounted for the people who disappeared in the past. Government spokesmen have suggested that the bulk of the disappeared are dead. Noting the statements of former detainees who report that most of their fellows were executed, as well as lack of evidence to the contrary, most observers also believe that the great bulk of the disappeared are dead.

A 1979 law shortening the period for a court finding of presumptive death has alleviated some personal hardships in legal and financial matters for the survivors of the disappeared. The law drew sharp criticism from Argentine human rights organizations, relatives, and the European Parliament, because of fears the government would misuse it to close arbitrarily, cases of disappearances. There have been no reports that the law in fact has been abused by the authorities. The government has now explicitly restricted the terms of the law to assure against potential official misuse. The Inter-American Human Rights Commission in its 1980 report has recommended that Argentina, to prevent new disappearances, should create a central register of detainees.

d. Arbitrary arrest and imprisonment

The Argentine constitution, in article 23, established the power of the executive branch to detain and hold prisoners under a state of siege (which has been in effect since 1974). The powers derived under this provision, as well as the prisoners held under its authority, are often described with the adjective PEN, the Spanish acronym for the National Executive Power (Poder Ejecutivo Nacional). The constitution places no explicit time limit for holding prisoners under the PEN powers. The supreme court, overruling a number of lower court decisions, has accepted broad and unsubstantiated charges of association with subversion as sufficient grounds for indefinite PEN detention. Some PEN prisoners have been in jail without charge for several years—including a significant number detained before 1976.

Since 1974, 8,200 perons accused of terrorism or subversion have been detained under the special executive powers of the president. By December 1980, those held on other than common criminal charges totalled about 1,550. Of these, about 600 had been tried and convicted in military or civilian courts, another 400 were in trial status, and about 550 were being held without trial and/or charges, some for many years or even after having served their sentences. The minister of interior said 300 are being held without charges. In December 1980 the government acknowledged that approximately 900 persons remain under PEN detention. The Argentine government informed the OAS General Assembly that in 1980 eight persons were detained under PEN powers; of these, six were referred to normal judicial procuedures and two were released under parole conditions. The government has set up a system to review periodically all pending cases, and 888 persons were removed from

PEN detention in 1980. The international Committee of the Red Cross has maintained a regular program of prison visits.

e. Denial of fair public trial

Persons accused of subversion or terrorism may be tried in either civilian or military courts. Civilian courts follow Argentina's customary legal provisions regarding open and fair trails. Argentine law, however, requires written rather than oral testimony, so that "open" has a different meaning and different consequences from those in other legal systems. The law provides that the civilian courts are independent, but the pressures accompanying trials involving subversion and terrorism have made it difficult for the courts to maintain independence. Military tribunals, before which civilians may be tried, conduct their proceedings in secret. The defendants have access only to a military defense counsel who is usually not a lawyer. Defendants legally may be kept unaware of the evidence against them in both military and civilian proceedings. The Argentine government, in its report to the OAS General Assembly, stated that in 1980, 157 persons were sentenced for crimes related to terrorism; 154 sentences were handed down by civilian courts and three by military courts.

Lawyers in the past generally have been reluctant to defend people charged with terrorism or subversion, fearing harassment or reprisals. The New York City Bar Association, following its visit to Argentina in April 1979, concluded that in 1975-1978 some lawyers disappeared or were detained if they defended clients and causes unpopular with the government. Over the past two years, no lawyers disappeared or were detained for such reasons, and it appears that the profession is operating more securely than in the past.

The independence of the courts is provided for in the constitution. In 1976, however, the government replaced all members of the supreme court and removed a number of judges in lower courts, though most were retained. The courts have often upheld executive interpretations of laws and of the constitution, and they have not successfully clarified the fate of any of the disappearances brought to their attention. However, there have been instances when the courts successfully challenged government actions and interpretations of its powers. In 1980, the supreme court ordered the courts to investigate disappearances fully when there is evidence suggesting government forces may have been involved. It remains to be seen whether the lower courts will be effective in carrying out the supreme court's directive. The 1980 report of the Inter-American Human Rights Commission recommends specific measures to assure legal due process guarantees.

f. Invasion of the home

The sanctity of the home has traditionally been protected by Argentine law, custom, and practice. The security forces, however, have often violated that sanctity during their anti-terrorist and anti-subversive operations. Available information suggests that violation of the home's sanctity still occurs, although the number of instances appears to have dropped sharply in 1980.

2. GOVERNMENT POLICIES RELATING TO THE FULFILLMENT OF SUCH VITAL NEEDS AS FOOD, SHELTER, HEALTH CARE AND EDUCATION

Argentina enjoys a high standard of living. In 1979 per capita income in current dollars was an estimated $3,400, and Argentine governments have—within the economic constraints of recent years—sought to confront social needs. Of total central government expenditures in 1979, 10.1 percent went to education, three percent to public health and 4.5 percent to housing. Infant mortality in 1970–79 was 59 per 1,000 births. Life expectancy is 69.4 years. There is one physician for every 530 persons, and a hospital bed for every 170. In 1978, 94 percent of the adult population was literate.

Argentina to date continues to maintain close to full employment. Official unemployment in Argentina was two percent in 1980, although some observers believe that there is some hidden unemployment. Argentina has traditionally enjoyed relatively equal distribution of income although it has become less equal in recent years, in part as a result of government policies designed to reduce inflation and revitalize the country's productive sector. Toward that end, the government has made an effort to open the economy to external competition by lowering tariff protection, reducing subsidies, and limiting state involvement in the economy. These policies, which greatly increased imports and discouraged exports, have recently resulted in a number of bankruptcies, belt-tightening for lower and some middle-income groups, and growing complaints from the private sector. The economy is currently in a period of reduced growth. Inflation continues to decline but is still high, running at about 90 percent for 1980, partly because of deliberate government

policy to maintain full employment and to provide substantial increases in real wages of public sector employees over the past several years. This has contributed to upward pressure on wages and prices throughout the economy.

Education has been free and is widely available, though the government is now moving to require tuition for university-level education. Government, private and trade union medical care programs make treatment available and affordable to most of the population.

Property ownership and transaction is a right of citizens. There is a serious housing shortage in Argentina, most of it attributable to now-defunct legislation that sustained rent control guidelines. The tax system is progressive and tax collections are increasingly effective, though compliance remains a problem.

Argentine women generally enjoy equal juridical status with men. Women's rights are not a contentious issue in Argentina, as jobs and educational opportunities, along with support systems that facilitate the simultaneous handling of job and family, are available, at least in urban areas. Sex discrimination is prohibited in education, politics, and employment. Tradition and social customs still limit women's participation in the work force.

3. RESPECT FOR CIVIL AND POLITICAL LIBERTIES, INCLUDING

a. Freedom of speech, press, religion and assembly

The Argentine constitution provides for these freedoms, but they have been circumscribed since the imposition of the state of siege in 1974. In 1980, exercise of freedom of speech and assembly expanded, although political leaders still risk arrest if they overstep the uncertain and undefined bounds of permitted political activity and statements. Civilian political leaders in 1980 commented extensively on the government's political dialogue, on its promise to issue a new law which will allow political parties to reorganize and renew their leadership, and on other government policies and actions. Included among the latter were the economic situation and human rights issues, including accounting for the disappeared. On the other hand, meetings of party leaders are sometimes prohibited or disrupted by the police and the participants detained, usually for brief periods. A regional political leader recently was arrested for violating the government's ban on political party activity, and a senior national political leader was detained and questioned after he reportedly criticized the government. The right of assembly for political groups has been suspended since March 1976 although, as noted above, the government has permitted a gradual increase of organized political activities by established political parties. Marxist parties to the left of the communists have been banned.

The press is not legally subject to prior official censorship except for moral content. However, government-imposed guidelines result in self-censorship. The Argentine Publishers' Association, after its annual meeting in 1980, issued a statement that "it is impossible to state that press freedom exists in Argentina." In the past, journalists have been among the Argentines who disappeared. Some are currently under detention. The government has intervened or confiscated a number of newspapers, notably La Opinion. Nevertheless, newspapers actively criticize the government in many areas and report the remarks of opposition politicians. Coverage of such issues as human rights and the disappearances increased during 1980. In August a declaration signed by 180 prominent Argentines calling for clarification of the whereabouts of disappeared persons was published in a prominent daily newspaper. Most foreign publications enter Argentina without censorship.

The Argentine constitution requires that the president be a member of the Catholic Church, and the majority of Argentines profess this faith. Other religions are required to register with the government; all but the Jehovah's Witnesses are permitted to function, and there are substantial minority religious groups, including a 300,000–450,000 member Jewish community. The government publicly condemns religious prejudice.

Argentine Jews have well-developed community organizations, exercise their religion without restraints and participate fully in Argentine economic and cultural life. The government maintains correct relations with the Jewish community and there is no evidence of official anti-Semitic policy, although incidents of anti-Semitism occur. During the height of the "dirty war" there were credible reports of anti-Semitic behavior by the security forces and persecution of Jewish prisoners. Virulent anti-Semitic literature remains on sale in the country and openly anti-Semitic attitudes have been tolerated in state-controlled television. Several Jewish schools were bombed in July and August and more received anonymous threats. Though the culprits were never found, the government sought to reassure Argentine Jews.

Until the end of 1980, the government continued to refuse to permit the legal registration of the Jehovah's Witnesses, who number approximately 30,000 in Argentina. Their properties and meeting places have been closed, and some Witness

children have been expelled from provincial school systems for refusing to salute the flag and sing the national anthem. The supreme court has ruled that two expelled primary school children should be allowed to return to school. In December 1980 the government revoked a decree which had precluded the Jehovah's Witness from seeking formal registration.

Several human rights organizations, uniting activists and relatives of the disappeared, have played a significant role in Argentina over the past several years. Some leaders of these groups were severely harassed and threatened in the past and several activists disappeared. In 1980 it appeared that the organizations were operating in a climate of enhanced security though there continued to be occasional harassment. The government in 1980 reaffirmed the right of human rights organizations to conduct their activities freely, and praised those groups that directed their efforts toward humanitarian rather than political goals. The "Mothers of the Plaza de Mayo"—relatives of disappeared persons—who used to assemble in front of the ministry of the interior in the Plaza de Mayo, were forcibly prevented from using the Plaza late in 1978, and in December 1980 a demonstration by human rights activists, including relatives of the disappeared, was broken up by the police with the use of considerable force. Twenty-seven demonstrators were arrested.

b. Freedom of movement within the country, foreign travel, emigration a repatriation

Argentine citizens are free to travel without restriction within the country and are free to emigrate. Married women living in Argentina must have the permission of their husbands to travel abroad with their children if the husband is not accompanying them. The Argentine constitution permits PEN prisoners to choose self-exile. Exercise of this "right of option" was denied by the current government until 1978 and subsequently restricted through implementation of an extensive screening process for all applicants. Many applications were denied during 1980, even though the applicants held documents authorizing them to enter other countries. Of the 711 cases handled thus far under the United States refugee program, 277 have been released.

Argentine has accepted about 300 Indochinese and 11 Cuban refugees.

c. Freedom to participate in the political process

Most elements of the democratic political process remain legally suspended in 1980. The government's declared intention is to return the nation to constitutional democracy but it has not established a timetable for realizing that goal. The government, in late 1979, promulgated a "political plan" containing broad guidelines for the eventual return of the country to civilian rule. In 1980, under the leadership of the minister of the interior, the government began a "dialogue" with many of the nation's political leaders. By the end of October, 41 meetings at the national level and 189 meetings at the provincial level had been held. Among the stated purposes of the dialogue is the development of legislation permitting the resumption of political party activity. As of December 1980, implementing legislation has not been issued although the dialogue with political leaders continues. In the meantime, the military designated another military president to serve until March 1984.

The government has subjected major trade unions to its intervention, replacing high-level union officials with military personnel, and prohibiting strikes. In 1976, and again in mid-1979, during periods of labor tension, the government detained a number of important labor leaders (almost all of these have since been released). Nevertheless, strikes for wage increases have occurred, and nearly all have been settled without violence.

In late 1979, after more than three years of study, the government issued a new trade union organization law and laid the groundwork for lifting the suspension of union activities which has been in effect since the armed forces took power in 1976. The law calls for the definitive dissolution of the old national confederation (CGT) and other "tertiary" organizations which have been under government control since 1976. Although the law makes no provision for such tertiary organizations, an informal national labor leadership continues to operate. It is not clear when the government will lift the suspension of the rights to strike and bargain collectively. From the government's point of view, the new law is designed to introduce more grass roots democracy and freedom of association for the workers than existed in the past; labor leaders, on the other hand, see it as an emasculation of union power, as it proscribes all political activity and greatly restricts control over social funds. The procedural steps for the implementation of the new law will not be clarified until the ministry of labor issues detailed regulations. The ICFTU condemned the law as a violation of union rights.

Although enjoying no official standing or recognition by the government, several labor groupings are active in making their views known. For example, they oppose the government's trade union law on grounds that it restricts freedom of association

and the right to organize as defined in conventions 87 and 98 of the International Labor Organization (ILO) as ratified by the Argentine government. They also oppose the new law's prohibition against political action by trade unions. The Inter-American Human Rights Commission has recommended the repeal or amendment of laws that prevent the normal development of trade unions. The Argentine government informed the OAS General Assembly that in 1980 Argentina filed regular reports with the ILO's Committee on Trade Union Freedom, which has noted progress.

4. GOVERNMENT ATTITUDE AND RECORD REGARDING INTERNATIONAL AND NON-GOVERNMENTAL INVESTIGATION OF ALLEGED VIOLATIONS OF HUMAN RIGHTS

In late 1978, the Argentine government invited the Inter-American Human Rights Commission (IAHRC) to visit Argentina. That visit took place from September 6 to 20, 1979. The Commission met with President Videla and other high-level officials, took testimony from family members of disappeared persons and from former prisoners, and visited several prisons and detention centers. The IAHRC recorded a past pattern of wide-scale human rights abuses, including violations by the government regarding the right to life, personal security, personal liberty, due process, and freedom of opinion, expression and association. The IAHRC also noted, however, that the Argentine government cooperated fully with the Commission during its visit and, that with the exception of the Jehovah's Witnesses, freedom of religion prevails in Argentina. It reported that there is no official policy of anti-Semitism, though in some instances Jews have been the subject of discrimination. The IAHRC formulated a series of recommendations to the Agrentine government for correcting the abuses it had observed. These recommendations included trial and punishment for those responsible for deaths attributable to the government, an official accounting for the disappeared, effective implementation of habeas corpus procedures, punishment of those responsible for torture, release or trial of those being held under PEN, improvement in prison conditions, effective guarantees of legal defense and due process, restoration of political rights, observance of trade union rights, lifting of prohibitions against Jehovah's Witnesses, investigation and punishment of discrimination against Jews, and facilitating the efforts of human rights organizations.

Argentina took strong exception to the Commission's report. In its 220 page response, it argued that the Commission infringed on the rights of a sovereign state, did not meet minimum standards of justice and objectivity and, rather than seeking to determine the facts of the situation, sought to establish already predetermined exaggerated and inaccurate conclusions. The government claimed that the IAHRC's report failed to reflect an understanding of the violence and social unrest existing prior to the military's takeover nor did its conclusions reflect the improved human rights situation at the time of the Commission's visit. Thus, asserted the government, while Argentina did not seek to avoid the report's criticisms and had welcomed the Commission's visit, the report left a false impression of human rights and conditions in Argentina.

The special IAHRC report on Argentina was considered by the Organization of American States General Assembly held in Washington, D.C. November 19-27, 1980. Argentina, in an informative note, reported actions taken in 1980 to improve the human rights situation, including a gradual decrease in the number of new persons detained by the executive, and a system for periodic review of pending cases, improved prison conditions, a decrease in the number of individuals said to have disappeared and official efforts to clarify the circumstances, an increase in judicial effectiveness, the devolution of state controlled media into private hands, the reaffirmation of the right of human rights organizations to conduct their activities freely, cooperation with the ILO, and efforts taken to restore political rights. The OAS approved a resolution specifying Argentina, as well as five other countries in which human rights violations had been discussed in either the IAHRC annual report or in special reports, and urged member states that had not yet done so to correct remaining violations. Although the subject of prolonged debate, the resolution was adopted by consensus.

The United Nations Commission on Human Rights is considering the situation of human rights in Argentina under its confidential 1503 procedures. A working group on disappearances is inquiring into cases of disappearances in Argentina and other countries. The International Committee of the Red Cross (ICRC) maintains an active program in Argentina, with government approval, on behalf of imprisoned persons. The government has usually facilitated the efforts of various groups and individuals seeking to investigate allegations of human rights abuse.

U.S. OVERSEAS—LOANS AND GRANTS—OBLIGATIONS AND LOAN AUTHORIZATIONS

[U.S. fiscal years—millons of dollars]

	1978	1979	1980	1946–80
Country: Argentina:				
I. Econ. assist.—Total	0.0	0.1	0.0	
Loans	0	.1	0	
Grants	0	0	0	
A. AID	0	0	0	
Loans	0	0	0	
Grants	0	0	0	
(Sec. supp. assist.)	0	0	0	
B. Food for Peace	0	0	0	
Loans	0	0	0	
Grants	0	0	0	
Title I—Total	0	0	0	
Repay. in dollars-loans	0	0	0	
Pay. in for. curr	0	0	0	
Title II—Total	0	0	0	
E. Relief ec. dev. & wfp	0	0	0	
Vol. relief agency	0	0	0	
C. Other econ. assist	0	.1	0	
Loans	0	.1	0	
Grants	0	0	0	
Contr. to IFI	0	0	0	
Peace Corps	0	0	0	
Other	0	0	0	
II. Mil. assist.—Total	0	0	0	
Loans	0	0	0	
Grants	0	0	0	
A. Map grants	0	0	0	
B. Credit sales—FMS	0	0	0	
C. Intl mil. ed. trng	0	0	0	
D. Tran-excess stock	0	0	0	
E. Other grants	0	0	0	
III. Total econ. & mil	0	.1	0	
Loans	0	.1	0	
Grants	0	0	0	
Other U.S. loans	27.4	32.7	79.2	
Ex-Im bank loans	27.4	32.7	79.2	
All other	0	0	0	
Assistance from international agencies:				
Total	548.4	388.7	485.9	3294.2
IBRD	165.0	96.0	237.0	1239.4
IFC	27.0	6.0	15.0	108.1
IDA	0	0	0	0
IDB	356.2	280.7	232.2	1893.5
ADB	0	0	0	0
AFDB	0	0	0	0
UNOP	.2	6	1.7	49.6
Other—UN	0	0	0	3.6
EEC	0	0	0	0

Chile

Chilean democracy came under increasing strains from the 1950s onwards as the result of rapid growth in political participation, slow economic growth and endemic inflation. In September 1973, as the result of severe economic dislocation and increasing violence broad opposition developed to the elected Allende government. The armed forces broke with their tradition of non-interference in politics and overthrew the government. The trauma of the Allende period (1970–73) and the view that his policies were leading to a Marxist state continue to influence the attitudes of many Chileans.

Rather than returning power to civilians after the coup, the military, led by General Augusto Pinochet, embarked on a wide-ranging effort to change the Chilean political and economic systems. In the period 1973–77, the regime undertook to curb dissent through a series of repressive measures, unprecedented in contemporary Chilean history. These included mass arrests, torture, exile and the disappearance of hundreds of persons. This period also saw the banning of political parties, the suspension of labor rights, the closing of many newpapers and radio stations, and the purging of the educational system.

There have been no confimed "disappearances" since October 1977. Arbitrary detention and cases of torture continued to occur in 1980 although there has been improvement since 1977 in the treatment of prisoners and general police procedures. Political parties remain formally dissolved, and basic freedoms of speech and assembly are restricted, although some political activity, criticism and limited press discussion is tolerated. Labor union activity continues to be under some restraints, but collective bargaining and the right to strike were restored, subject to new limitations by the 1979 labor law. The continuing "state of emergency," extended regularly every six months, gives the government extraordinary authority similar to that under a state or siege. The right to due process was weakened further in 1980. By means of decree laws, the government reinstituted executive-ordered internal exile for periods of up to three months; further, the authorized period of detention without formal charges was extended from five to twenty days in internal security law violations involving death, injury or kidnapping. In several instances, however, the courts and press have taken positions defending human rights.

Following two years of relative calm, Chile suffered a moderate increase in extremist violence during 1980, including armed robberies, attacks and bombings in which three carabineros, an army officer and several innocent bystanders were killed. While increasingly active Movement of the Revolutionary Left (MIR) groups have claimed credit for some of these incidents, their involvement in others, particularly the assassination of an army officer in July, has not been established. A few MIR members have died in gun battles with police. Suspicions that rightist extremists are also active continue in the absence of any breakthroughs in solving these major cases. In July the government detained approximately 20 civilian police detectives, reportedly associated with a right-wing organization, in connection with a series of kidnappings in which some of the victims were tortured and a university student was beaten to death; the matter is now in the hands of the civilian courts, but no charges have yet been brought for the death. Two have been charged for one of the kidnappings.

With respect to socio-economic policy, the administration decided in 1975 to reduce the role of government, open the economy to world market competition and reform taxation. GNP growth has since averaged more than 7 percent per year in real terms, inflation has declined from over 300 percent to about 30 percent, unemployment has declined gradually from just under 20 percent to about 10 percent and real wages have increased more than 80 percent. High growth rates and better tax collection have enabled the government to increase social spending both in real terms and by comparison with previous periods in Chilean history. Social spending is now targeted primarily at the poorest 20 to 25 percent of the population. An important effort in health and nutrition programs has cut the infant mortality rate in half from 1973 to 1979. The government has increased real spending at all levels of education, including university education, but has increased the percentage allocated to pre-primary, primary and intermediate levels in order to eliminate illiteracy.

In September 1980, the government held a plebiscite seeking approval (by means of a simple yes or no vote) of a new consitution and political transition plan. The plan restores congressional elections in 1990 and regular presidential elections in 1997. In 1989 there will be another plebiscite on a junta-proposed candidate for president until 1997. The alternative to approval was continuance of the status quo. Approximately 93 percent of eligible voters cast ballots; 66 percent voted "yes", 30 percent voted "no", 1 percent cast blank ballots and 3 percent cast void ballots. Opposition leaders criticized the content and procedures of the plebiscite, arguing that it did not permit free debate or a meaningful choice, and that opponents did not have equitable access to the communications media. The new constitution is to take limited effect beginning in March 1981.

1. RESPECT FOR THE INTEGRITY OF THE PERSON, INCLUDING FREEDOM FROM

a. Torture

The 1925 constitution forbids torture. Constitutional Act No. 3, issued in September 1976 to strengthen and perfect the rights recognized in the 1925 document, recognizes the right to life and integrity of the person and forbids the

application of all illegal constraints. High-level government officials publicly and privately deny that the use of torture by government agents is authorized. Reports of torture declined from 1976 through early 1980. Since then, paralleling an increase in extremist violence, reported incidents of torture increased. At least 100 incidents of torture were reported to human rights organizations in 1980—with most individuals alleging psychological duress, beatings and the use of electric shock during interrogation by members of the National Information Center (CNI) or civilian police. While in some cases questions can be raised about the validity of the allegations, in other cases there is no apparent reason for the individuals to make false claims. According to such accounts torture was applied in the first or second day of detention to allow sufficient time for full recovery before release.

Local human rights organizations have expressed concern that the lengthening of the period of executive detention from five to 20 days in internal security law violations involving murder or kidnapping could facilitate more sustained physical abuse.

b. Cruel, inhuman or degrading treatment or punishment

Human rights sources report that during the first ten months of 1980 the courts received 96 complaints of serious mistreatment including torture. Three men have died since November 1979 while in the custody of civilian police. Accounts by relatives suggest that physical abuse by police was the cause; the cases are under investigation but no persons have been indicted. While a large percentage of detainees report correct treatment, some persons detained during peaceful demonstrations or otherwise picked up on suspicion of proscribed political activities, have complained of beatings and being forced to remain unclothed for extended periods of time. The living conditions of the various locations to which the government has ordered individuals into internal exile vary considerably.

In prison, persons detained for political or terrorist activities are normally separated by cell blocks from common criminals. They are able to receive visits from, and communicate with, family, friends, legal counsel and representatives of the International Committee of the Red Cross (ICRC).

c. Disappearances

The last reported "disappearances" occurred in 1977. About 635 cases from the period 1973–1977 remain unresolved. Although the Chilean supreme court appointed special judges in 1979 to investigate many of these disappearances, no one has been formally indicted. This year, the supreme court confirmed that the general amnesty declared in 1978 applied to the policemen identified as having executed sixteen persons and deposited the bodies in a lime kiln at Longuen in 1973. The special judges are continuing investigations into some cases, have suspended action in numerous others, and have referred still others to military justice when the military or police are believed to have been involved. Some families of the disappeared have appealed the suspension or referral to the military courts. To date, the appeals have had little effect in resolving the whereabouts of their relatives.

d. Arbitrary arrest and imprisonment

Although the government has denied holding political prisoners, there are more than 100 persons formally sentenced or in trial process for seditious activity. Most are accused of violating either the Internal Security Law or the Arms Control Law, or both. Some cases date from before the military takeover. In 1980 a few of those who had been sentenced were allowed to exchange prison for exile.

People detained for participating in banned public demonstrations or illegal meetings are often held for the full five days permitted under executive discretion and then may be released (the large majority of cases), sent into internal exile, or charged with internal security violations. In those cases reaching the courts, the investigating judges may take up to five more days to deliberate but, in practice, have rarely issued indictments.

When people are detained, friends or relatives normally report the detentions, the press publicizes them and the government eventually acknowledges them. According to studies compiled by church human rights reports, a total of 729 persons were detained in Chile during the first six months of 1980. For the subsequent period of mid-July through mid-September, which included activities related to the September 11 plebiscite, about 350 detentions occurred—including those individuals picked up and subsequently released within a matter of hours.

In theory, the right of habeas corpus (writ of amparo) exists; however, in internal security cases the courts often do not act on such petitions in either a rigorous or timely manner. Based upon a recommendation by the church in May 1980, the supreme court in June 1980 instructed lower and military courts to issue more expeditious and rigorous rulings on these writs. State or emergency provisions

authorize the president, or minister of interior acting in his behalf, to order the executive detention of persons without charge for up to five days. Under a new decree law, this period can be prolonged to twenty days in internal security investigations involving murder, kidnapping or other injury. A few arrests not falling into this category have also resulted in detentions longer than five days. Civilian and military courts have another five days, from the time of arraignment, to decide whether to indict.

Court investigations into the kidnappings and torture carried out in mid-1980 by civilian detectives, reportedly acting without authorization, have resulted in the indictments of two senior detectives, but only so far in relation to one of the women who was held. No one as yet has been charged in the kidnapping of the other persons, including the student who died from blows he received.

The intelligence service (CNI) has only limited legal authority to arrest people on its own initiative; in practice, it has been able to obtain vaguely-worded warrants which provide considerable latitude in making searches or arrests. The public concern aroused by the unauthorized kidnappings by civilian police has led to greater care by security agents to identify themselves and to show warrants when detaining people.

e. Denial of fair public trial

Chile's civilian judges are career officials and most have served in the judiciary since before the present military government took power in 1973. Since 1978, most violations of the ban on political activity and most cases relating to alleged human rights abuses have been handled in the civilian court system. A decree law of February 1980 shifted first instance jurisdiction for the prosecution of proscribed political activities from the appellate courts to the regular lower level proceedings of the criminal courts.

Civil court proceedings are conducted in accordance with Chile's civil code tradition. There is no trial by jury; reliance is placed on the written record. In the criminal courts of first instance, a judge serves multiple functions: as investigator, with the aid of the police or others as prosecutor; as defense attorney, at times; and, ultimately, as the one who decides the innocense or guilt of the accused. Criminal proceedings begin when the court of the accused receives a report of a crime, or a compliant by interested parties, or when the judge begins an investigation. In the investigatory stage, the judge can either suspend the proceedings, in case of innocense, or name the presumptively guilty party. When the latter occurs, the proceedings move to a second, more open, stage which allows for defense rebuttal. Once these activities have been completed, the judge issues a finding of innocense or guilt with appropriate punishment. These decisions may be appealed up to the supreme court.

Criticisms of the functioning of civilian courts focus not on the procedures, but rather on the general unwillingness of judges to assert a vigorously independent role or, with rare exceptions, to effectively challenge the legality of actions by the executive under emergency powers. In cases involving alleged human rights abuses by uniformed personnel, civilian judges have frequently reached a determination that they lacked jurisdiction to proceed further. The Inter-American Human Rights Commission (IAHRC) reported in October 1980 that the rights to fair trial and of due process were subject to major significant restrictions—principally because of the active role of the military courts in judicial proceedings and the failure of the civil courts to exercise their responsibilities on behalf of detained persons.

Arms control violations go before a military prosecutor; he carries out the investigation and then makes recommendations to a military judge, who issues the decision. Appeals may be made to a military court of two civilian judges and three professional military judges and, in the last resort, to the supreme court. Defendants have the rights of any Chilean citizen before the law, including the right to legal counsel. An April 1979 anti-terrorist decree law makes all members of an organization responsible for the acts of each member and establishes legal presumption of guilt in cases covered by the decree; it has not been invoked, however.

f. Invasion of the home

The 1925 constitution and Constitutional Act. No. 3 prohibit searches of the home and interception of private communications and documents except as determined by law. Provisions in the penal code require search warrants issued by either a judge or military prosecutor for specific locations. In practice, however, such searches are carried out under a general order issued by the judge or prosecutor. Human rights organizations report that legal formalities, such as the display of a warrant, have not been observed by the authorities in a number of searches.

2. GOVERNMENT POLICIES RELATING TO THE FULFILLMENT OF SUCH VITAL NEEDS AS FOOD, SHELTER, HEALTH CARE, AND EDUCATION

Government policy aims at a rapidly growing free enterprise oriented economy in which most workers have increased real income, and public welfare spending is focused primarily on the poorest quarter of the population. In response to the foreign exchange crisis and a continuing high level of inflation, the government introduced a drastic austerity program in 1975. Also, copper prices declined by half between 1974 and 1975. The Chilean economy underwent its worst depression since the 1930's, hurting Chileans in every economic stratum. According to most analyses, the greatest hardships were borne by the lowest income groups although in relative terms middle and upper income groups suffered a greater fall in net income. The depression bottomed out in early 1976. Since then the economy has expanded at historically unprecedented rates.

Major policy changes which have been introduced in the last five years include reducing tariffs in stages to their present basic level of 10 percent, establishing a realistic exchange rate, returning many small- and medium-sized nationalized companies to the private sector, reducing or eliminating various price controls, special interest subsidies and regulatory mechanisms, reducing and then eliminating deficit spending and radically altering taxation by indexing corporate and individual taxation of dividends, and various loopholes and substituting the previous cascading sales tax with a value added tax. From 1976 to 1979 real GDP growth averaged 8.3 percent per year—more than twice the historical average. By 1977, GDP in real terms had begun to surpass previous peak levels. Real GDP growth is estimated at 6.0 percent in 1980, and per capita GPD should surpass $1800. At the same time inflation has been brought down to 30 percent. Real wages increased 83 percent from 1976 through mid/1980. International reserves have accumulated to a net $2.4 billion.

The unemployment rate, however, remains high at 10.2 percent. It is down considerably from 19.6 percent reached in March 1976, at the bottom of the depression. The unemployment rate would be higher if it were not for the 5.1 percent of the labor force participating in the government's minimum employment program. This figure has more than doubled in the past year because of an eligibility liberalization which permits more than one member of a family to be enrolled in the program. The persistently high unemployment rate is attributable in part to the structural adjustments in the economy; there are also increased numbers of people, particularly women, in the labor force. A 1979 University of Chile study suggests that the poor have benefited proportionately more from the successes of Chilean economic policy. On either a personal or family income basis in the greater Santiago area, income of the most affluent 20 percent of the population has grown more slowly since 1976 than any other category while that of the poorest 20 percent has grown most rapidly. As a result, the degree of income concentration has declined since 1976 and is now approximately the same as at the start of the decade in 1970. Critics of the government's economic policies have argued that the income of the poor fell disproportionately between 1974 and 1976 and that wealthy remains highly concentrated.

The government is attempting to make its social programs more efficient by focusing its efforts on the poorest quarter of the population, considered to be in "extreme poverty." In late 1979, it established a social council of ministers to oversee a social coordination plan for fiscal expenditures on social welfare programs. The amount to be invested in 1980 is $2.64 billion, representing more than 50 percent of the total central government spending. This figure includes normal ministry budgeting in the social field and also a new $161 million emergency social fund intended for high-impact, high-visibility anti-poverty projects. These government expenditures will amount to $238 per capita, the highest (in constant dollars) in Chilean history. As part of its administrative reform effort, the government issued in June legal guidelines for transferring administrative responsibility for social services, including schools and health care facilities, to municipalities, while maintaining financial oversight.

In education, the government has given increasingly greater funding support to pre-primary, primary and intermediate levels, relative to the university level in order to increase the country's 90 percent literacy rate (77 percent in rural areas). During 1980, the government also instituted a new literacy campaign.

Government health and nutrition programs have led to a reduction in the incidence of malnutrition in the officially reported infantile population (less than six years of age) from 15.5 percent in 1975 to 12 percent in 1979 and in the incidence of advanced malnutrition from .7 to .2 percent. There were similar declines in infant mortality (from 65.2 to 36.3 per thousand live births) and maternal mortality at childbirth (from 1.32 to .73 thousand live births) from 1973 to 1979. Over the same

period, the overall death rate per thousand fell from 8.4 to 6.8, increasing average life expectancy from 64.2 to 65.6 years.

Social security expenditures in real terms have continued to increase. Regulations have been changed to eliminate discrimination against blue collar workers, and benefits have been extended to a wider segment of the population, including 110,000 indigent elderly and handicapped, not previously eligible. In addition, in late 1980 a new social security plan was begun under which employees would pay 17 percent of their salary toward their pensions and life and health insurance, firms would increase salaries of these employees by 18 percent, and the funds collected would be invested by private companies in a limited range of triple-A type securities and investments. The employees pension and insurance money is protected by the requirement that the investment companies must contribute from their capital if their earnings fall 7 percent below the industry average and, failing this, the absorption of the company by other companies and a government contribution to make up the shortfall. The plan decreases the overall cost to the employee by 9.7 percent and strengthens the social security system by investing the funds in earning assets. Critics of the social security reforms argue that this will reduce some benefits. It should be noted that workers may choose voluntarily between moving to the new system and remaining under their current plan.

Public housing expenditures are small in comparison with evident needs. Although funding levels have risen since 1978, they still amount to little more than half of peak levels in 1973. At the same time, programs have been overhauled to benefit the most needy rather than the middle class. In addition to expenditure policy, the government has also been revising the tax structure in favor of lower income categories; in a recent change, it raised the percentage of taxpayers totally exempt from income tax liability from 38 to 66 percent. The main thrust of the economic policy in housing is to encourage the private sector to fill this need. In 1980 construction of a record 50,000 residential units were started.

The impact of government economic policies on lower income portions of the population remains a controversial issue in Chile. On the one hand, it is argued that the present economic policies have not brought down the high level of unemployment fast enough, and the unemployed are mostly low skilled and low income. On the other hand, it is argued that Chile's historically endemic inflation and hyperinflation of the early 1970's had the most severe impact on low income people so that the present reduction of inflation has helped the poor. While the present regime is making a determined effort to channel more resources to poorer sectors, there remains a tremendous breach between resources and needs. A recent World Bank report noted, moreover, that the government's policies were directed primarily to the urban poor and barely addressed the problem of rural poverty.

According to statistics gathered by the University of Chile for the Santiago area (surveys have not been made for other regions), the proportion of income earning females over 14 years of age has been recovering from a sharp drop caused by the high unemployment of the mid-1970's. Although still slightly below the level reached in the early 1970's, the employment figure for women has recovered more rapidly than that for male wage earners. Women currently constitute 28.5 percent of the work force.

The education level of females appears to be improving more rapidly as well. The survey results for the Santiago area indicated that the proportion of females over 14 years of age with better than primary education rose from 41 percent in 1970 to 51 percent in 1978. At the same time, the corresponding figures for males, though still higher, increased from 48 percent to 57 percent.

Middle and upper class women generally have good access to education and upper class women generally have good access to education and entry-level professional jobs. Women do not occupy a proportional share of upper level decision making positions in the major institutions of government, business and academia. There are marked differences in the distribution of incomes for females in comparison with males. Among women, 28.3 percent (again, according to the Santiago survey) fell within the lowest income category and only 11.5 percent within the highest, whereas almost the reverse pertains to men. In the current government, there is one woman of cabinet rank and several just below the ministerial level. This past September, President Pinochet announced plans to establish a new ministry of the family, which will also address the concerns of women.

Women wishing to travel abroad with minor children must have the father's written permission, even in the event that the courts have granted custody to the mother. On the other hand, a mother must obtain a court order to prevent the father from taking the children abroad. This disparate treatment is common in Latin America.

3. RESPECT FOR CIVIL AND POLITICAL LIBERTIES, INCLUDING

a. Freedom of speech, press, religion, and assembly

A basic constitutional act decreed by the government in 1976 states that "any individual or group action is illegal and against the institutional order of the republic if such action is aimed at spreading doctrines which oppose the family, propose violence or a society based on class struggle; or which are against the constituted regime or the integrity or function of the state of law." In curbing dissent, the government usually cites other more specific legal provisions and decrees outlawing Marxism and the advocacy of violent revolution.

Virtually all public meetings require prior approval of the local military zone commander. In practice, permission is regularly denied when the subject is politically sensitive. Among exceptions, the government permitted a pre-plebiscite opposition rally attended by about 40,000 in Santiago in August 1980, and ignored various smaller opposition meetings. Except during the pre-plebiscite period most demonstrators who met without authorization in 1980 were arrested and held for brief periods. The government charged some with violations of the internal security code but the courts did not find adequate basis for judicial action.

A decree law of February 1980 gave the government authority to internally banish persons for up to three months without charges, court review or the right of appeal. Previously, such action had been possible only under state of siege authority. Since the decree took effect, over 100 individuals have been internally exiled, some to remote towns far from their homes and families.

The media are technically free from official prior censorship, but, in practice, the government informally tells publications and broadcasters when they are considered out of line. Thus, self-censorship is widely practiced, with most editors careful about the content of material prior to its release, although articles which are critical of the government appear regularly in several leading publications. Under state of emergency authority, local military zone commanders can close down media, restrict coverage of internal security cases, forbid publicity of non-official activities of government officials, and prevent the sale or distribution of new publications. In one case this year, the Santiago zone commander prevented the distribution of a new book on the 1973 Longuen killings, although dozens of articles and reports have been published in media on this subject. In another case, the zone commander prevented the start of a new magazine. The latter decision was reversed by an appeals court and then appealed by the government to the supreme court which upheld the zone commander.

The government owns the only national television network. Other local or regional stations are operated by the universities, whose rectors are appointed by the government. While the directors of these TV stations have autonomy, they use considerable discretion. There are several periodicals and at least two radio stations critical of the regime; these give major voice to the opposition viewpoint and were very active in the period leading up to the plebiscite. "Non-Marxist" books and pamphlets critical of the government are permitted free circulation.

In its 1979 annual report, the Inter-American Press Association noted improvements in press freedom in Chile, but concluded that restrictive laws, particularly controlling new publications, resulted in a lack of full press freedom.

Chile, predominantly a Catholic country, respects freedom of religion. A number of Protestant and other sects are active. The Jewish community reports full freedom and tolerance.

In 1979 the right to elect student government was restored at the universities. Rectors of the universities are military men. Vice Rectors are university professionals.

Labor unions

Most trade union rights, suspended after the military takeover in 1973, were legalized again in July 1979 by the "Labor Plan" (a series of decree laws forming a labor code), or its subsequent technical additions and revisions although in a number of respects these rights are limited. The trade union movement had no practical input into the formulation of the labor plan.

In general, even labor leaders favorable to the government and with access to high ranking officials have minimal influence on important labor matters. Opposition labor leaders have neither access nor influence and are occasionally subject to public attacks by government officials.

Trade union organizations can normally elect their leaders instead of having them appointed by the government. In individual unions, however, elections are not obligatory, and there are some instances where appointed leaders have managed to hold off having elections despite rank and file sentiment to the contrary. As elections continue to be held, the number of appointed leaders are gradually decreasing.

On some occasions the government has facilitated the formation and the smooth functioning of labor organizations favorable to it, while opposition labor organizations at times suffer bureaucratic and other forms of harassment.

Collective bargaining has resumed for the large majority of workers—albeit in a somewhat restricted fashion. Workers are guaranteed their existing wage and benefit package, plus any increase in consumer price index. Since the last adjustment (for the year up to July 1980), the average real increase was 7–8 percent. On the other hand, the scope of what can be bargained has been narrowed considerably to include only wages, benefits paid in cash or in kind, and certain common conditions of employment, such as safety.

Specifically excluded from collective bargaining are the civil service and the maritime sector; in the latter case, special presidential legislation to be promulgated in the future to regulate that sector.

Each year, the government publishes a list of those entities which can bargain collectively but are classified as "strategic." As such, they are prohibited from striking. Approximately thirty were listed in 1980. Most are public utilities and state-owned firms. For these companies, failure to reach agreement during negotiations leads to binding arbitration.

For workers who can bargain collectively and can strike, the right to strike is limited in the sense that, after the 60th day of a strike, all striking workers are considered to have resigned their jobs, and they can be permanently replaced by the employer. Also legal for the first time in Chile is management's ability to hire strikebreakers, an effective strike deterrent given the presently high unemployment rate.

There is no grievance procedure system in Chile. The only recourse available to an aggrieved party is to appeal to the labor tribunals, a procedure which usually takes several months. Strikes cannot result from an individual grievance; they are only permitted in the case of a failed collective negotiation.

b. Freedom of movement within the country, foreign travel, emigration and repatriation

Chileans are free to leave their country. Some one million Chileans live abroad, principally for economic reasons. Over half this number have resided for many years in Argentina (mainly Patagonia) where they provide the basic labor pool. In the judgment of international organizations dealing with refugees, the volume of skilled and unskilled workers returning to Chile now slightly exceeds the number leaving—a reflection of the improvement in the Chilean economy.

Many thousands fled Chile when the current government took power; hundreds sought asylum in foreign embassies, thousands were convicted of internal security violations and had jail sentences commuted to exile. The government was eventually willing to grant safe conduct passes to people who obtained asylum and wanted to leave Chile. Expulsions are no longer a regular practice by the government in dealing with opponents, although there was at least one instance in 1980 involving a prominent politician.

Government decrees require those who are considered to have left Chile illegally to file a petition with a Chilean consul if they seek to return. The interior ministry reviews all petitions and rejects those from people who are considered to have engaged in anti-government activities abroad. The government has released no current figures on petitions received, rejected, approved or pending. In most cases the courts have upheld interior ministry decisions barring individuals from returning. In a small number of cases, the government has permitted some barred individuals to return generally for short periods and on humanitarian grounds.

Chile has accepted a few refugees in recent years and makes regular modest financial contributions to international organizations aiding refugees.

c. Freedom to participate in the political process

Political party activity in banned. In 1973, the government dissolved the Marxist parties and other parties forming the Unidad Popular Political Front. A 1977 decree law dissolved all remaining parties. There have been no elections for local or national political office since 1973. There was universal suffrage in the September 1980 constitutional plebiscite (voting is required by law), but without electoral registers or other safeguards acceptable to the opposition. Following the 1973 coup, the government assumed, authority to amend the constitution. With congress dissolved, the junta exercises legislative powers, delegating executive authority to President Pinochet.

Notwithstanding the formal ban on political activity, the non-Marxist parties, notably the Christian Democrats and some of the Radical Party Offshoots, are able to continue to operate on a limited basis. Even some socialists and splinter leftist groups maneuver among themselves with tacit government acquiescence. Commu-

nists who are found engaging in political activities are generally detained for violating the internal security code or the 1973 law prohibiting Marxist activity.

4. GOVERNMENT ATTITUDE AND RECORD REGARDING INTERNATIONAL AND NONGOVERNMENTAL INVESTIGATION OF ALLEGED VIOLATIONS OF HUMAN RIGHTS

The government set a precedent when in July 1978 it allowed members of the special ad hoc working group of the United Nations Commission on Human Rights (UNHRC) to conduct a long-delayed visit to Chile. Although the groups subsequently disbanded, a special rapporteur was asked to submit Chile human rights reports to the commission and the U.N. General Assembly (UNGA). The Chilean government communicated officially to UN authorities in March and May of 1979 its objection to, and refusal to cooperate with, continuing special consideration of Chile by ad hoc procedures, such as the use of a rapporteur, contending that these measures had no legal or moral force.

A Chile item appears each year on the agenda of the UNGA and the UNHRC. The 1980 UNGA resolution expressed "particular concern that the Chilean authorities have failed to take and urge effective measures, as requested in its resolution 33/175, to investigate and clarify the fate of persons reported to have disappeared for political reasons", and urging the authorities of Chile to respect and promote human rights in accordance with the responsibilities it has undertaken under various international instruments.

The Inter-American Human Rights Commission also maintains a watching brief on the Chilean situation. In its October 1980 report on human rights in Latin America it stated that "There have been violations of the right to life and personal security in Chile" and that severe restrictions on the exercise of other rights embodied in the American Declaration of the Rights and Duties of Man continue. In late 1978, the ICRC reduced its Chilean presence to one local employee primarily because of the substantial decline in the number of political prisoners. Earlier it had played an active role in prison visits in attempts to locate missing persons. The Intergovernmental Committee for European Migration (ICEM) also has been active in Chile, conducting a program permitting convicted political prisoners an opportunity to serve out their sentence in exile. The government cooperated in making this program possible. Counting all categories of refugees, ICEM has moved some 20,000 people out of Chile since the coup.

Amnesty international, the International Commission of Jurists and other nongovernmental organizations have expressed special concern over Chile. During 1980, the first two organizations issued reports alleging a relative increase in human rights violations in Chile and criticizing the courts for their ineffectiveness in protecting the rights of detainers or people who have disappeared. Although the government believes that the reports produced by these organizations exaggerate the scope and volume of abuses, it has permitted visits by their representatives.

The Catholic Church, along with the representatives of several other religious communities, has taken the lead in defending human rights and implementing social action programs. This has resulted in visable tensions between the government and the church, and disagreement over the church position by more conservative Catholics.

In a number of instances, church property has been the target of attacks carried out by assailants who have not been identified or apprehended.

The Chilean Commission for Human Rights, now two years old, has also publicized abuses and spoken out strongly against them. It and the other human rights groups operate openly, albeit cautiously, in Chile; some of their members have experienced harassment in the form of arrests and searches.

The Chilean government has failed to investigate fully and prosecute three former security officers indicated in the U.S. for complicity in the 1976 assassinations of ex-Chilean Ambassador to the U.S. Orlando Letelier and a U.S. citizen, Ronni Moffitt. In October 1979 the Chilean supreme court denied a U.S. government extradition request for the three officers.

U.S. OVERSEAS—LOANS AND GRANTS—OBLIGATIONS AND LOAN AUTHORIZATIONS

[U.S. fiscal years—millions of dollars]

	1978	1979	1980	1946–80
Country: Chile:				
I. Econ. assist.—total	7.1	13.5	10.2	.....
Loans	0	0	0	.....
Grants	7.1	13.5	10.2	.....

U.S. OVERSEAS—LOANS AND GRANTS—OBLIGATIONS AND LOAN AUTHORIZATIONS—Continued

[U.S. fiscal years—millions of dollars]

	1978	1979	1980	1946–80
A. AID	.2	.3	.1	
Loans	0	0	0	
Grants	.2	.3	.1	
(Sec. supp. assist.)	0	0	0	
B. Food for Peace	5.6	9.0	5.0	
Loans	0	0	0	
Grants	5.6	9.0	5.0	
Title I—Total	0	0	0	
Repay. in dollar—Loans	0	0	0	
Pay. in for. curr	0	0	0	
Title II—Total	5.6	9.0	5.0	
E. relief. ec. dev & WFP	0	0	0	
Vol. relief agency	5.6	9.0	5.0	
C. Other econ. assist	1.3	4.2	5.1	
Loans	0	0	0	
Grants	1.3	4.2	5.1	
Contr. to IFI	0	0	0	
Peace Corps	1.3	1.3	1.5	
Other	0	2.9	3.6	
II. Mil. assist.—Total	0	0	0	
Loans	0	0	0	
Grants	0	0	0	
A. Map Grants	0	0	0	
B. Credit sales—FMS	0	0	0	
C. Intl. Mil. Ed. Trng	0	0	0	
D. Tran-excess stock	0	0	0	
E. Other grants	0	0	0	
III. Total econ. & mil	7.1	13.5	10.2	
Loans	0	0.0	0	
Grants	7.1	13.5	10.2	
Other U.S. Loans	46.0	0	0	
Ex-Im Bank loans	0	0	0	
All other	46.0	0	0	
Assistance from international agencies:				
Total	62.3	35.0	79.8	1,046.6
IBRD	0.1	0	74.0	425.5
IFC	0	0	0	14.3
IDA	0	0	0	19.0
IDB	59.5	35.0	0	522.2
ADB	0	0	0	0
AFDB	0	0	0	0
UNDP	2.3	0	5.8	58.2
Other—UN	0.4	0	0	7.4
EEC	0	0	0	0

COLOMBIA

Colombia has been ruled by freely elected governments for all but five years (1953–57) of the present century. The constitution provides for a popularly-elected president and congress and an independent judiciary. Two political parties, the Liberal and Conservative, dominate Colombian politics. The constitution mandates that the president's party must give the other principal party "adequate and equitable" representation in the government. The present chief executive is a Liberal, but six of thirteen cabinet positions are held by Conservatives. Minor parties exist and are legal in Colombia, although none has attracted widespread popular support in recent years.

The constitution guarantees numerous civil and political liberties as well as some social benefits. A constitutionally-authorized state of siege, which permits the curtailment of some civil and political freedoms, has been imposed increasingly during

the last 20 years and is currently in effect. A "security statute" decreed by the government in 1978 provides for military trials of civilians accused of certain crimes and has come under severe criticism by human rights and opposition groups as denying basic human rights. The government has argued that these measures are necessary because politically inspired violence over the past thirty years threatens Colombia's institutions. The Colombian government has notified the United Nations (UN) under Article 4 of the International Covenant on Civil and Political Rights that extraordinary measures are necessary in Colombia.

The attempts to eliminate this violence resulted in numerous charges of human rights violations, including torture, and increased attention by local and international human rights groups to the situation in Colombia. In response, President Julio Cesar Turbay Ayala invited Amnesty International to study the human rights situation in Colombia, and a commission from that organization visited Colombia in January 1980. In February, guerrillas from the April 19th Movement (M-19) seized and held the Embassy of the Dominican Republic in Bogota for two months; among the diplomatic hostages was the American Ambassador. In the midst of the crisis, Amnesty International issued its preliminary report, which was very critical of the Colombian human rights record. The report was rejected by the Colombian government as insensitive to Colombia's serious problem of subversion and as ignoring efforts made by the government to correct violations that had occurred. As part of the settlement which eventually led to the release of the hostages, President Turbay asked the Inter-American Human Rights Commission (IAHRC) to come back to Colombia to investigate charges of human rights abuses. The Commission has not yet issued its report.

PARAGUAY

Paraguay is a predominantly agricultural country with a population of three million. It has traditionally been governed by authoritarian regimes and has a history of wars, rebellions and coups. *The country has been ruled under state of siege provisions of the constitution since 1929.* President Alfredo Stroessner, an Army general, has governed Paraguay since 1954 under these provisions and there has been no effective challenge to his authority. He is actively supported by the extensive political apparatus of the majority Colorado Party, the Armed Forces and the Police.

Violations of respect for the integrity of the individual have decreased but credible reports of cruel treatment and punishment were received in 1980 and the political and civil rights guarantees provided for in Paraguay's constitution continue to be violated. Opposition political elements are not able to participate effectively in the political process, and affiliation with the Colorado Party is often a prerequisite for significant participation in the nation's burgeoning economic activity. The judiciary, while formally independent, does not constitute an effective check to executive branch actions.

During the last two decades, there has been rapid economic growth and the *poorer elements* of the population have been *among the prime beneficiaries.* In addition, the government's land distribution program has given farms to over one-sixth of the nation's small farmers.

1. RESPECT FOR THE INTEGRITY OF THE PERSON, INCLUDING FREEDOM FROM:

a. Torture

Article 5 of the constitution guarantees the physical integrity of the individual. Nevertheless there are recurring reports of torture. The most credible cases in 1980 involved two Argentine nationals and a member of the Paraguayan Communist Party, who were reportedly tortured during the early stages of detention to obtain information.

b. Cruel, inhuman or degrading treatment or punishment

The Paraguayan police are reliably reported to mistreat prisoners during the early stages of detention. Such mistreatment is said to include beatings, forced standing for long periods of time, withholding of food, lengthy isolation, verbal abuse and threats against detainees and their families. The Paraguayan security forces and armed political groups allegedly used harsh methods in a search for the perpetrators of a bus hijacking in March 1980 in eastern Paraguay in which two government officials were wounded. During a manhunt near Caaguazu following the incident, up to 200 people were detained for varying lengths of time, and allegedly were subjected to verbal threats, beatings and physical abuse. Human rights groups have received charges that persons engaged in the manhunt summarily executed at least three persons in the aftermath of the incident.

Conditions in police stations are poor but in most cases detainees are transferred fairly quickly to the national penitentiary where conditions are generally better.

There have been no reports of cruel, inhuman, or degrading treatment or punishment during subsequent detention in regular prison facilities. Representatives of the International Committee of the Red Cross are normally allowed access to detainees. No known disciplinary actions have been taken against officials accused of cases of torture, cruel, inhuman or degrading treatment or punishment.

c. Disappearances

During 1980 no case of disappearance is known to have occurred.

d. Arbitrary arrest and imprisonment

There were about 600 political prisoners in 1977. Almost all have since been released. Releases in 1980 included a prisoner who had been held for 16 years without charges and a peasant leader who had been rearrested in early 1979, after having previously spent eight years in jail, and charged with a variety of political and common crimes. The latter departed Paraguay soon after his release. Four political prisoners were in custody as of October 1980, including three members of the illegal Communist Party. Political prisoners are usually held under the state of siege provisions of the constitution or anti-subversion law No. 209. Perhaps 10–15 other persons are being held arbitrarily under circumstances which, in some cases, suggest political motivation. In September–November 1980 eight campesinos were held without charge and then released. A recent publication of the International Committee of the Red Cross (ICRC) notes that its regional delegate in mid-1980 visited various places of detention and met seven persons held for political reasons. Habeas corpus is not honored in these cases and such prisoners can be held indefinitely. During 1980, there were also a number of short-term detentions, for what were essentially political reasons, although criminal charges were sometimes filed. One case involved a prominent opposition politician who was rearrested under the state of siege provisions in October, held incommunicado, and released several weeks later. In another case earlier in the year, two leading journalists were detained for 28 and 67 days respectively. Two political opposition members were forcibly exiled to the interior for two months, before being released.

Several hundred people were detained arbitrarily in the aftermath of the assassination in Paraguay of former Nicaraguan President Anastasio Somoza. These people, many of whom were foreigners, were held from a few hours to several days but a few may still have been in custody at year's end. Many of the foreigners were summarily expelled from Paraguay without legal proceedings.

e. Denial of fair public trial

Paraguay has a well-developed body of laws and penal codes. While legal proceedings are reported in the press, and are formally in accord with the constitution, the judiciary is subject to executive and military influence and there are also charges of extensive judicial corruption. Fair trials in political cases generally are not possible.

A report issued in 1980 entitled *Mbarete, the Higher Law of Paraguay*, under the auspices of the International League for Human Rights, concluded that there were no due process safeguards in political cases. The report came to the following conclusions regarding the procedures for trying political prisoners under anti-subversive Law 209: "First, the prosecutions did egregious harm to legal and constitutional rights; second, as administered by the Paraguayan judiciary, fair trials were not achieved; third, dominated by superior executive power and extra-official influence, the judges acted lawlessly and without judicial integrity." The same report also alleged the existence of an "unwritten code based on a hierarchy of power given the name in the Guarani language of Mbarete. Mbarete is the higher law, superior to any and all norms postulated by the legal system."

The 1980 annual report of the Inter-American Human Rights Commission recognized a "relative improvement in the general human rights situation" in Paraguay. At the same time it pointed out that "essential rights such as life, personal freedom, physical safety, religious freedom, freedom of association, the right to a fair trial, the right to expression of thought and information, and the right of residence and travel, are frequently obstructed by measures proceeding directly or indirectly from actions taken by government agencies."

f. Invasion of the home

Under the law, judicial warrants are necessary before the security forces can enter private homes. However, citing the state of siege provisions of the constitution, the police have conducted searches, detained persons, and impounded or expropriated personal property without judicial warrant. Such actions were widespread in the aftermath of the Somoza assassination.

2. GOVERNMENT POLICIES RELATING TO THE FULFILLMENT OF SUCH VITAL NEEDS AS FOOD, SHELTER, HEALTH CARE, AND EDUCATION

The government of Paraguay, in seeking to improve living conditions, takes a largely laissez-faire approach to economic and social questions, and relies on private organizations to fulfill needs in these areas whenever possible. Government policies have contributed to the achievement by Paraguay of a high sustained level of economic growth for the past three years. An estimated 18.8 percent of central government expenditures went to public health, education and housing, an increase over recent years. Despite increased spending, education and health services, especially in rural areas, remain inadequate.

Government fiscal policy is conservative, and this has contributed to relative price stability in Paraguay. However, an unparalleled influx of foreign capital has intensified expansionary pressures within the economy. Inflation in 1980 is estimated at 20 percent. Due to rising income levels and improved tax administration, central government revenue is expanding rapidly but important potential sources of revenue continue to escape taxation.

Until the past decade, Paraguay was virtually isolated economically; 90 percent of its trade was directly with Argentina and almost 100 percent of its imports came through Argentina. The economic growth of Brazil along its frontier with Paraguay, the growth of commercial agriculture, and the beginning of the exploitation of the hydroelectric potential of the Parana River, have all effected enormous changes in the Paraguayan economy and society. There has been a general and significant increase in living standards, a considerable growth in the middle class, rising wages, and a greater participation in the commercial sector by foreigners. Electricity generation, telephone service and water supply, all government utilities, have kept pace with the burgeoning private sector, but as noted, some sectors such as education and health care have lagged in some areas.

The National University is poorly equipped and has been criticized as being dominated by the Colorado Party. The independent Catholic University is striving to improve its facilities. Teachers' pay in public primary schools is extremely low, about one-half of the minimum wage in the private sector. Most families with adequate means prefer to send their children to private schools. According to the government, the literacy rate is about 80 percent, and about 90 percent of children between 7 and 14 years of age go to school. The functional literacy rate is probably lower.

Basic economic statistics show the GNP per capita for 1980 as $1,500 (estimated). The minimum wage is $6.25 per day. Unemployment is almost nonexistent. There are no statistics about underemployment. Population growth rate is about 3.1 percent per year; population distribution is about 40 percent urban and 60 percent rural; life expectancy is 62 years; and the infant (less than 1 year) mortality rate is about 75 per thousand. There are about 1,700 doctors, 3,000 hospitals beds, 1,500 trained technicians and 300 nurses in the country serving a total population of 3,000,000 people.

Income distribution remains a concern. There are no official data but a small group of insiders appears to be profiting inordinately from the current boom. However, real wages may have increased slightly in 1980. There is little abject poverty or misery, and government homesteading and colonization programs have benefited major sectors of the rural poor. While poorer Paraguayans are sharing the exceptional growth that the country is experiencing, perhaps 15 to 20 percent of all households remain largely outside the money economy. The Paraguayan government has taken steps to overcome past neglect of unassimilated Indians and to promote and improve that status, but full integration into the economy and political life of Paraguay has not been achieved.

Paraguay is underpopulated. The government has a policy of land distribution which provides land to those who want to work it. However, clear titles to land and security of land rights are often difficult to obtain.

The great majority of Paraguayans live between marginal and middle income levels. Economic opportunities are enhanced if one is a member of the governing party, but most of the business community has prospered regardless of political affiliation.

3. RESPECT FOR CIVIL AND POLITICAL LIBERTIES, INCLUDING

a. Freedom of speech, press, religion, and assembly

The media exercises self-censorship and the government, in 1980, continued to issue press guidance to the directors and senior editorial staff of the leading newspapers. Two journalists were detained for 28 and 67 days respectively during 1980, and *El Pueblo*, the organ of the opposition "Febrerista" Party, was closed in October

1980 and has not reopended. Despite government pressures, the press in Paraguay reports independent and opposition viewpoints and criticism of the government is generally tolerated—except for criticism of the President, key military and some civilian government leaders. Radio and television are controlled by the government or its supporters, and reporting is less open than in the press. Opposition parties are not allowed access to electronic media to air their views.

Freedom of assembly continues to be subject to limitations. Opposition political partiers, whether recognized by the government or not, are frequently denied the right to hold public meetings. Security forces, particularly outside of the captial, have allegedly intimidated opposition politicians to prevent even private meetings in homes.

There is no truly independent labor movement in Paraguay. The Federation of Paraguay Workers (CPT) represents over 90 percent of organized labor. The CPT is the only recognized labor organization; it is controlled by the government, and is dominated by the Colorado Party. A few unions associated with the opposition parties belong to the CPT.

The CPT has been moving in recent years toward a more independent stance. Individual unions have shown some bargaining power, particularly in the banking sector, and where foreign firms are concerned. Strikes have not been permitted, however, and collective bargaining efforts have often been frustrated by private firms despite legal guarantees.

The Paraguayan constitution guarantees religious freedom for existing religious groups, and their activities are conducted freely. Recent legislation has prohibited the conferring of legal status on any new religious groups. The Jehovah's Witnesses', who lost their legal registration in 1979, cannot use their established meeting houses for religious purposes.

b. Freedom of movement within the country, foreign travel, emigration and repartriation

The constitution provides for freedom to travel and, within Paraguay, this freedom is normally honored. Most citizens may enter and leave the country freely. However, officials have often refused to issue travel documents to political opponents, former political prisoners, or persons who criticize the government. Emigration is normally allowed and Paraguay has a policy of providing asylum to foreign refugees. Many political opponents of the government, particularly a dissident section of the Colorado Party, have been forced into exile over the years. Although some have been allowed to return, they can do so only by undertaking not to participate in the political life of the country. Paraguay has followed a policy of welcoming immigrants. Europeans, Japanese, Brazilians, Koreans as well as large numbers of members of fundamentalist religious sects have settled in Paraguay.

c. Freedom to participate in the political process

The Paraguayan government is authoritarian. Only members of the dominant Colorado Party in good standing can fully participate in the political process. Individuals are under pressure to join the Colorado Party to gain access to economic and social advantages which are subject to government influence, such as admission to the National University, access to government employment, and the right to bid on public contracts. The government often appears to identify legitimate dissent with subversion and seeks to justify subsequent harassment of political opponents and critics on the basis of national security.

General elections are held every five years and the law requires all Paraguayans 18 years and over to vote. Some political groups are not allowed to participate and one recognized party refuses to do so. Two opposition parties are recognized and do participate, at least formally, in elections, and have representation in congress. The Communist Party is banned by law.

Equal rights for women are guaranteed by the Paraguayan constitution. The traditional social system limits the participation of women, especially those from lower income groups. Women have traditionally played an inferior role in Paraguayan political life, and the executive and judiciary have few prominent women officials. There are three women in the 90-member congress, and several others are politically prominent. An increasing number of women are participating effectively in various professions, business and the artistic life of the country. Women normally receive less remuneration than men for comparable work.

4. GOVERNMENT ATTITUDE AND RECORD REGARDING INTERNATIONAL AND NON-GOVERNMENTAL INVESTIGATION OF ALLEGED VIOLATIONS OF HUMAN RIGHTS

The Paraguayan government responds to inquiries from international human rights bodies including the United Nations Human Rights Commission (UNHRC)

and the Inter-American Human Rights Commission (IAHRC). The UNHRC is considering the situation of human rights in Paraguay under its confidential 1503 procedures. Despite repeated commitments over the past three years, the government has not yet scheduled an on-site visit in Paraguay by the IAHRC. The IAHRC annual report recommended that the government of Paraguay set an early date for onsite observation. The government has allowed visits by non-governmental human rights organizations.

A critical report by the International League for Human Rights was published in 1980 following its visit to Paraguay the previous year. Amont its recommendations were the restoration of habeas corpus and the lifting of the state of siege. There have been no other visits by international groups concerned with human rights during 1980. Paraguay has signed, but not ratified, the American Convention on Human Rights.

The Paraguayan Human Rights Commission and the Inter-Faith Committee composed of three church groups are both active in the human rights area in Paraguay. Both organizations have been subject to governmental criticism and harassment.

U.S. OVERSEAS—LOANS AND GRANTS—OBLIGATIONS AND LOAN AUTHORIZATIONS

[U.S. fiscal years—millions of dollars]

	1978	1979	1980	1946–80
Country: Paraguay:				
I. Econ. assist.-total	3.5	10.3	3.6	
Loans	0	5.0	0	
Grants	3.5	5.3	3.6	
A. Aid	1.8	7.1	1.3	
Loans	0	5.0	0	
Grants	1.8	2.1	1.3	
(Sec. supp. assist.)	0	0	0	
B. Food for Peace	0.3	0.3	0.4	
Loans	0	0	0	
Grants	0.3	0.3	0.4	
Title I-Total	0	0	0	
Repay. in dollars-loans	0	0	0	
Pay in for. curr	0	0	0	
Title II-total	.3	0.3	0.4	
E. Reliev. ec. Dev & WFP	.3	0.3	0.4	
Vol. relief agency	.0	0	0	
C. Other econ. assist	1.4	2.9	1.9	
Loans	0	0	0	
Grants	1.4	2.9	1.9	
Contr. to IFI	0	0	0	
Peace Corps	1.1	1.9	1.9	
Other	.3	1.0	0	
II. Mil. assist.-Total	.6	0	0	
Loans	0	0	0	
Grants	0.6	0	0	
A. MAP grants	0	0	0	
B. Credit sales-FMS	0	0	0	
C. Intl mil. ed. trng	0.6	0	0	
D. Tran-excess stock	0	0	0	
E. Other grants	0	0	0	
III. Total econ. & mil	4.1	10.3	3.6	
Loans	0	5.0	0	
Grants	4.1	5.3	3.6	
Other U.S. loans	0	0	0	
Ex-im bank loans	0	0	0	
All other	0	0	0	
Assistance from international agencies:				
Total	104.7	97.2	76.6	629.1
IBRD	39.0	64.0	36.0	229.3
IFC	0	0	0	5.4
IDA	0	0	0	45.5
IDB	64.2	31.2	39.4	321.1
ADB	0	0	0	0

U.S. OVERSEAS—LOANS AND GRANTS—OBLIGATIONS AND LOAN AUTHORIZATIONS—Continued

[U.S. fiscal years—millions of dollars]

	1978	1979	1980	1946–80
AFDB	0	0	0	0
UNDR	1.4	1.4	1.2	22.0
Other-UN	0.1	0.6	0	5.8
EEC	0	0	0	0

Representative REUSS. Representative Richmond.

Representative RICHMOND. Thank you, Mr. Chairman.

Mr. Secretary, I entreat you to brief yourself on Japanese-American relations. I entreat you to brief yourself on Japanese-American relations from your own colleagues.

Mr. RASHISH. May I ask in what respect my colleagues disagreed with what I said?

Representative RICHMOND. First of all, Mr. Secretary, the bulk of what the United States ships to Japan is nonrenewable. When you grow an acre of corn in the United States you lose 5 tons of top soil. That's not renewable. Every single year the top soil in the United States is becoming less and less and less.

Mr. RASHISH. Every time you sell a manufactured product you're using a raw material.

Representative RICHMOND. Mr. Secretary, I don't mind shipping out the corn, but I would like to ship it out in the form of boxed beef. That would give our corn farmers some business, our beef people some business, our slaughter houses some business, our freezing people some business, and we could ship that boxed beef to Japan and sell it there where there's an enormous market for it—the Japanese will stand in line for it—and under $5 a pound. I'm all in favor of that. We ought to get after them for restricting the imports of beef.

Second, do you realize the Japanese, on one side, won't accept anything from us? They have rigid barriers, You said there's free trade.

Mr. RASHISH. I didn't say there was free trade.

Representative RICHMOND. The Japanese use 500,000 tons of beef a year and they only allow us to ship——

Mr. RASHISH. We have quotes on certain agricultural imports, too.

Representative RICHMOND. We have no quotes on Japanese goods, even though we manufacture every single product we get from Japan. We invented that product. We designed that product. We are now buying it from Japan. We have no quotas or tariffs on those products.

Mr. RASHISH. Let me make clear what I said. I said the average level tariff applied by Japan is no higher than that applied by——

Representative RICHMOND. No. I'm telling you that the average level of tariffs applied by Japan is two and three times as high as the United States. Semiconductors is a good example.

Mr. RASHISH. I said averaged across the board.

Representative RICHMOND. Mr. Secretary, believe me, it costs twice as much for an American car in Tokyo, and a Japanese car

in Detroit can be purchased for the same price you pay for it in Tokyo.

Mr. RASHISH. I don't disagree with that, but it has nothing to do with the average tariff level.

Representative RICHMOND. Mr. Secretary, I have been working on this for many months. I have been to Japan and I'm going back to Japan. I'm giving you some good advice which I wish you would give back to the President. It's a big item. We could singlehandedly reduce the deficit by 50 percent. Twenty-five billion dollars could be returned to the Treasury if Japan would give us a fair deal. All I want you to do is look into it. You say we are not the loser and they are not the loser. We are the losers because I want American labor to process food, to process beef, and to process orange juice. The Japanese have an enormous demand for our orange juice, yet they still erect artificial barriers against our orange juice.

Do you realize the Japanese won't allow Boeing to ship more than 65 percent of a plane over to Japan. They insist on completing the other 35 percent themselves. If they feel that way, why don't they ship 65 percent of their automobiles over here and we'll finish the other 35 percent? Everything we have with Japan is out of balance. All I'm entreating you to do is talk with your colleagues, Mr. Baldrige, Mr. Block, and Ambassador Brock, and you will find my facts are correct and perhaps you could then advise the President to whisper into Prime Minister Suzuki's ear that the party is over and that the American people aren't going to stand for it.

Mr. RASHISH. You say that the President—if the President whispers in Prime Minister Suzuki's ear on the subject, it won't be the first time he's heard this story. We have been working this piece of the territory over quite intensively ever since the beginning of the administration, but I think it's also important to know what it is you want to achieve with the Japanese and in what issues you're vulnerable, and it's clear they do maintain highly restrictive import controls on certain agricultural imports that we have considerable comparative advantage in, including the famous beef and citrus. And, of course, the MTC in the previous administration was able to get some modest liberalization of that, not enough. I agree with you that we ought to be after the Japanese to eliminate all restrictions on imports and to make maximum availability of their market to our suppliers.

Now that isn't going to happen overnight. Plus, as good as we are on trade policy—and I think we're damned good—we don't even have that kind of system in effect. But I think the Japanese have room for more progress in this respect than we do and I expect that the heat will continue to be on and we are not going to have to wait for a major round of trade negotiations to get them to see that their own interest lies in opening up their market. That's part of the business that's going on now. They are getting a lot of heat, not only from us but from Europeans. If they see their export markets may be in jeopardy if they don't adjust, and rather than restrict exports, I think the Japanese are sensitive enough to realize that if they open up their market for imports they get a better deal by going that way rather than face restrictions on exports to Europe and the United States.

What we have to do is approach that particular task in an environment in which we are not ganging up on the Japanese; we are not making it difficult politically for them to take the steps that we'd like to see them take; and I think the best and most productive and congenial environment for that purpose is the existing international institutional arrangement that we have in the field of international trade, the GATT.

We are not agreed to go to a ministerial meeting next year, the first one since 1973 that kicked off the Tokyo round of multilateral trade negotiations, once we have agreed—contingent on an agreement on the right kind of agenda.

We have just begun a trade initiative study in the OECD at the ministerial meeting in mid-June and I think it's in that framework—two organizations in which the Japanese are present and are members—it's in that kind of a framework and in the context of sort of forward momentum and liberalizing the world trade system and improving the rules of trade that I think we get the best shot at getting the Japanese to do what I think they ought to do in their own interest.

Representative RICHMOND. I agree with you, Mr. Secretary. I don't want to wait 2 or 3 years. I think the American Treasury could well use that $25 billion now and not 3 years from now. What we're talking about is 50 percent of the national deficit and if the Japanese would just equalize trade with us and pay 1 percent of our gross national product toward their defense bill we would have another $25 billion in our budget. We could use that a lot more then Japan can because they are no longer our little brothers or our equal partners right now. Thank you.

Representative REUSS. Thank you very much, Mr. Secretary. I know you have to go to your appointment and we are most grateful to you. We have enjoyed your being with us and look forward to seeing you in the future.

Mr. RASHISH. Thank you very much. I hope we can renew the discussion at an early date.

Representative REUSS. The committee is recessed.

[Whereupon, at 10:55 a.m., the committee recessed, to reconvene at 10 a.m., Thursday, July 16, 1981.]

[The following letter, together with an enclosure, was subsequently supplied for the record:]

DEPARTMENT OF STATE,
Washington, D.C., August 20, 1981.

Hon. GILLIS W. LONG,
U.S. House of Representatives,
Washington, D.C.

DEAR MR. LONG: Under Secretary Rashish has asked me to convey the answer to a number of the questions you posed in your letter of July 17, 1981. These responses are enclosed.

Three of the questions you asked concern the interagency process established by the Reagan Administration for making decisions on international economic issues. The State Department has been a full participant in this process and from our standpoint it works well. For answers to your specific questions, I would, however, refer you to the White House Office of Policy Development, which established and manages the inter-agency process and can give you more precise details on its structure and how it works.

Sincerely,

RICHARD FAIRBANKS,
Assistant Secretary for Congressional Relations.

Enclosure.

Question 1. What is your own assessment of the wisdom of United States or Western participation in construction of the Yamburg Pipeline?

Answer. I am concerned about the strategic risks associated with the pipeline and look forward to discussing with the Europeans alternative sources of energy that may be as attractive as the pipeline in terms of the combination of commercial and security considerations. From my first days in office, I have privately counseled our European allies and friends that their increased dependence on Soviet energy resources, and natural gas in particular, could have serious security implications. At the same time, however, we wish to avoid a public disagreement about the pipeline with our allies, which would only serve Soviet interests.

We are now moving toward detailed discussions with the Europeans of Europe's projected needs for additional gas imports, alternative sources of gas and other energy supplies, and means to mitigate the political risks of proceeding with plans to import additional natural gas from the Soviet Union.

Question 2. Congress continues to push for the creation of a Department of Trade; Do we need such a Department?

Answer. In testimony on June 4, 1981 before the Senate Committee on Government Affairs, the Department of State joined other administration witnesses in recommending against creation of such a department, at least until the Trade Reorganization of 1979 has been given a chance to work. While the Department fully agrees that aggressive promotion and marketing of American goods and services is a principal national goal, a new reorganization effort at this time would absorb the energies of trade policy officials and distract from their current efforts to strengthen U.S. export policy. The Department of State is also concerned over proposals that have been made by the Congress to shift functions from this Department to a new trade and investment agency. Such a shift would seriously impair the ability of the Secretary of State to carry out his foreign affairs responsibilities in a manner fully supportive of U.S. economic interests. There is no doubt that our security and prosperity depend as much on our global economic position as on our military strength, and that the attitudes of both our allies and adversaries are influenced by how this economic power is projected abroad. To deprive the Secretary of State of important elements of his already small economic staff would make his decisions and advice to the President on foreign policy less sensitive to U.S. trade and economic concerns.

Question 3. Should USTR and the Commerce Department be combined?

Answer. As is the case with a new Department of Trade, the Department of State feels that the time is not appropriate to consider any additional, extensive reorganization proposals. We believe that the trade policy mechanism under the direction of USTR is working well.

Question 4. Would the Commerce Department be more effective with a clear focus on trade, industry, and services?

Answer. Commerce already has a number of people working on trade, industry and services. We are not in a good position to comment on whether Commerce's internal organization could be strengthened to enable it to play a more effective role in these three important areas.

Question 5. What is your own assessment of potential European energy dependence on the Soviet Union if the pipeline is constructed?

Answer. It is difficult to assess what European dependence and vulnerability might ensue from a decision to proceed with the pipeline. Many of the details of the project are still under negotiation. Furthermore, European energy vulnerability will depend on a large number of factors including the actual volumes of Soviet supplies, overall European dependence on gas, the reliability of other suppliers, and the scope and scale of "safety net" procedures that might accompany the pipeline.

Question 6. Given our decision to export grain to the Soviet Union, how can we object to European or Japanese participation in the construction of the pipeline?

Answer. Our decision to sell grain to the Soviet Union and the Europeans' desire to purchase gas are not analogous. We are proposing to sell to the Soviets a nonstrategic commodity that is vital to them, thereby fostering, to some extent, their dependence on us. The Europeans on the other hand, propose to depend on the Soviets for supply of a vital commodity. We are concerned about potential European vulnerability to Soviet pressure, attendant to such prospective dependence.

Question 7. Without Western capital and technology, will the pipeline be constructed? How much difference would U.S. technology alone make?

Answer. The Soviets must depend on Western capital and equipment to construct the pipeline. Key items which must be imported from the West are large diameter pipe, pipelayers, and equipment for compressor stations.

All equipment imports central to the construction of the pipeline are available from non-U.S. sources. The United States does not produce the 56 inch pipe planned

for the pipeline, although a number of our allies, including the FRG and Japan, can supply pipe of that size. Pipelayers are available in Japan, and Italy's Fiat-Allis has developed a prototype pipelayer suitable for the pipeline. In addition, the British company Rolls Royce can supply gas turbines, the central component in compressor stations, without U.S. source parts.

THE OTTAWA SUMMIT AND U.S. INTERNATIONAL ECONOMIC POLICY

THURSDAY, JULY 16, 1981

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The committee met, pursuant to recess, at 9 a.m., in room 2128, Rayburn House Office Building, Hon. Henry S. Reuss (chairman of the committee) presiding.

Present: Representatives Reuss, Richmond, Brown, and Wylie.

Also present: James K. Galbraith, executive director; Charles H. Bradford, assistant director; and William R. Buechner and Robert E. Weintraub, professional staff members.

OPENING STATEMENT OF REPRESENTATIVE REUSS, CHAIRMAN

Representative REUSS. Good morning. The Joint Economic Committee will be in order for its further studies of upcoming events in international economics.

We are privileged to have before us our friend, Chairman Paul Volcker of the Federal Reserve System. Mr. Volcker has a prepared statement, which he delivered to us in good time yesterday so we would have a chance to study it, and which, under the rules, will be received in full into the record.

Chairman Volcker, as you know, Vice Chairman Jepsen, Congressman Wylie, and I belong to the Gold Commission, which is having its organizing meeting at 10 a.m. today. So we appreciate you coming an hour earlier than we had all thought necessary, and it is quite likely that we will be able to finish up by 10 a.m. I know you won't mind being on your way.

Would you care to summarize your prepared statement now, so that we could have that before us, and then we will proceed with the questioning?

STATEMENT OF HON. PAUL A. VOLCKER, CHAIRMAN, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. VOLCKER. I would be glad to, Mr. Chairman. I appreciate the fact that your time is limited. I congratulate you and your membership on the Gold Commission on those deliberations.

You have asked for me to discuss various international economic policy issues at a time when these are under considerable discussion in advance of the summit meetings. I would just summarize my prepared statement by agreeing that there are of course issues of serious concern for a number of countries.

External factors complicate this job of economic management; that is always the case. It is sometimes the case that external factors complicate our job as well. I think it would be wrong to attribute all the problems that other countries are having currently to our policies.

The main point I would make is that there is very strong and widespread support for the basic purposes of our policies, in the sense that I think all developed countries—and developing countries, for that matter—given the key role of the United States in the world and the key role of the dollar, attach great importance to our dealing with inflation here and creating conditions that will, in the long run, lay the base for stability in our economy and stability in the dollar.

Certainly, without an understanding of our mutual purposes and problems, difficulties and emotions could run high and complicate the job for all of us. But the burden of my report really is that, among financial officials with whom I am in fairly constant contact, there is, indeed, considerable understanding of what we are doing and how we are going about it. There is certainly sympathy with the purposes I suggested; there is certainly wide recognition of the need for restraint on money and credit growth and, I think, recognition of the fact that in the current circumstances that inevitably means higher interest rates than anyone would like to see—higher interest rates than we would like to see at home and higher than other countries would like to see us have.

I recognize that that is, perhaps, an inevitable fact of dealing with the inflationary problem and that this problem does deserve priority. The last paragraph of my prepared statement contains what seems to me a fairly apt summary of the thinking among foreign financial officials that was reported to me recently. I am loosely quoting that thinking:

"You cannot expect us to be enthusiastic about the effects of your policies. We all have different opinions about just how you are going about it. But the fact is, we have no agreed better alternatives to offer you. We can only wish you success."

I would think that captures the essence of the comments of foreign financial officials to me. What is important is that we are successful in the objective of dealing with inflation, which seems to me and to them central to stability over time and central to growth and economic progress both in the United States and elsewhere.

Thank you very much, Mr. Chairman.

[The prepared statement of Mr. Volcker follows:]

PREPARED STATEMENT OF HON. PAUL A. VOLCKER

I appreciate the opportunity to appear before this Committee to present the Federal Reserve's views on the international implications of U.S. macro-economic policies, and particularly monetary policy.

Inevitably questions arise, abroad, as they do in this country, about particular techniques and implications of U.S. economic policies. After all, nearly all of the nations represented at the Ottawa Summit, and most others, are faced with difficult problems and choices in developing economic policy, and external influences on their interest rates and exchange rates inevitably raise new complications for some—just as at time external developments complicate our own policy-making. However, the expression of such concerns should not be taken as disagreement with the basis intent or trust of our policies, certainly not among those most closely concerned with financial policy. I base that judgment on my own discussions with central bankers and finance ministers abroad as well as on the conclusion reached

in May at the meeting of the IMF's Interim Committee in Gabon and more recently at the OECD Ministerial meeting.

Accordingly, I expect that the President will hear a general endorsement of the broad purposes and objectives of U.S. economic policies when be meets next week with other heads of state and governments. Specifically, I believe that the priority the United States has attached to the fight against inflation is widely appreciated. Indeed, the leaders of these very nations, along with many others, have long urged us to adopt rigorous and convincing anti-inflation policies, and I do not believe they will change that attitute now.

Foreign officials do rightly stress that, in our interdependent world, U.S. economic developments and policies have ramifications for the policies and performance of other economices. Our weight in the world economy, while relatively smaller than in the early postwar years, is still very significant, and leaders abroad have to take U.S. economic policies into account when they formulate their own programs. They do want us to be aware of the external implications of high dollar interest rates and a rising dollar, as we should be. The short-run effects—abroad as well as at home—can indeed be discomforting. But we should also have a sense of proportion about those effects.

The United States should not and can not assume the responsibility for all the economic difficulties of particular countries. In some instances—for example, countries with sizable balance-of-payments deficits—some depreciation of their currencies relative to the dollar may have been natural, and a number of countries have internal reasons for following firm monetary policies. Changes in exchange rate relationships within Europe have been relatively small recently, and most of the trade of those countries is not affected by the substantial appreciation of the dollar. The point is often made in the context of the dollar's appreciation that oil and other commodities are priced in dollars, but it should also be pointed out that monetary restraint in the United States has contributed importantly to squeezing out inflationary excesses in those markets.

In general, it is rarely easy to trace through the relative weight of different forces impacting on the economic policy problems of different countries. We all—certainly including the United States—must guard against at temptation to assign undue responsibility to external forces. I would remind you that any exchange rate involves two national currencies; a change in that exchange rate may reflect policies or developments in either country, or more likely both at the same time. The recent "strength" of the dollar vis-a-vis some currencies headlined in the press has been relative; it may be—indeed has been—influenced by conditions abroad, as well as in the United States. I would note that short-term interest rates in the United States are a bit lower today than at the turn of the year, and interest rate differentials are narrower with respect to continental European currencies. Yet the dollar has appreciated substantially against those currencies over the past six months.

Because of the potential for misunderstanding, and because developments and policies here do have effects on other countries whose leaders face difficult economic problems and choices, we have a clear responsibility to listen closely to their views, to explain our policies carefully, and to respond to constructive, substantive criticism. Prolonged misunderstanding is always dangerous, for economic and political friction could impair the fabric of the open international economy that serves us all. My perception is that, fortunately, there is broad understanding of our objectives and policies—combined, of course, with a good deal of impatience in awaiting results, just as is sometimes the case at home.

The essential point about U.S. economic policies—monetary, fiscal and other—is our commitment to reducing inflation. Most of the foreign leaders with whom I have talked readily agree that it is in their countries' fundamental interest, as well as ours, that the United States make significant progress against inflation. Because of the dollar's role in world financial markets and because of the U.S. prominence in the world economy, a necessary condition for the restoration of stability in currency markets and for the resumption of sustained, worldwide economic growth is the restoration of greater price stability in the United States.

Obviously, they, as we, would like to see lower and more stable U.S. interest rates and less variation in exchange rates. Everyone would agree that reduced inflation and a clear sense of movement toward price stability must be the basis for maintaining such stability over time. Against that background, international discussions raise questions of means, not ends.

As you know, Federal Reserve monetary policy has been directed at restraint in the rate of growth of the monetary aggregates. Some observers—and they are not confined to those outside our borders—believe we are following a policy deliberately directed at achieving high interest rates and dollar appreciation. Such views are mistaken; the Federal Reserve has neither an interest rate nor an exchange rate

objective. We do take the view that persistent restraint in the growth rates of the monetary aggregates is necessary to ensure lower inflation—and therefore lower interest rates—over time. I find no disposition among my colleagues abroad to question that necessity.

In the short run, interest rates are a function of the many factors that influence the demand for money and credit, including the budgetary position of the government, the strength of business activity, and the inflationary momentum. So long as actual and expected inflation and nominal demand remain strong, high interest rates should not be surprising. Only when inflation slackens significantly, and markets believe the slowdown will be sustained, can we look forward to meaningful, sustained declines in dollar interest rates, consistent with growth in real activity.

Relative interest rates can and do influence exchange markets. But that influence has to be judged in the context of other influences working at the same time. As I have already suggested, it would be a mistake to attribute the roughly 20 percent weighted-average appreciation of the dollar since December of last primarily to the behavior of nominal interest rates on dollar assets. The differential between U.S. interest rates and short-term interest rates on average in foreign industrial countries has declined about 2½ percentage points since the end of 1980. U.S. short-term interest rates are now about 1 percentage point less than their December average. Interest rates on the continent of Europe are appreciably higher, yet their currencies have depreciated substantially relative to the dollar. Interest rates in two of the Summit countries—Japan and the United Kingdom—have declined so far this year, and in one of those countries—Japan—the depreciation of its currency relative to the dollar has been smaller than that of the continential European currencies. The yen, as well as the Canadian dollar, has experienced a weighted-average appreciation so far this year.

Obviously, one must look beyond absolute or relative interest rates to explain the dollar's appreciation this year. Among the other relevant factors in the United States have been the first signs of some improvement in our relative inflation performance, a continuation of a relatively favorable U.S. current-account position, and favorable assessments of the potential of the new Administration's economic program. On the other side of the Atlantic, balance-of-payments deficits have been large, and there has been a sense of greater political change and uncertainty.

A number of foreign observers while not questioning the need for monetary restraint in the United States have suggested that monetary policy should not carry so much of the burden of the stabilization effort either here or in their own countries. As you know, I have also often emphasized the importance of fiscal restraint and regulatory and other policies, alongside firm restraint on the money supply, in a comprehensive program to reduce U.S. inflation. At the same time, we all have to recognize the difficulties in changing these policies dramatically and quickly. We are in fact making progress in reducing the strong upward trend in government expenditures—and I would remind you that the administration has emphasized that more will need to be done in future years, particularly if we are to reap the benefits of tax reduction in a context of reduced budget deficits. The closer the budget is to balance, all else equal, the less pressure will be felt in financial markets, the lower interest rates will be, and the danger of abnormal exchange rate pressures will be lessened. But it would be unreasonable to expect a balanced budget overnight, and I believe there is a growing understanding abroad, as at home, that fiscal policy cannot easily be shifted in the short run. After all, most other governments are grappling with fiscal problems at least as difficult as our own.

It is equally important to recognize that there are no "quick fixes" available through monetary policy to lower or fine tune interest rates. If the Federal Reserve, for example, were to deviate from its policy of monetary restraint in an effort to lower interest rates, any seeming short-run relief would have to be balanced against the substantial risk—for the United States and the rest of the world—of excessive credit growth, a further hardening of inflationary expectations, and still greater interest rate pressures in the future.

"Like others, I shall applaud lower interest rates in the United States any day if they signal success in the battle against inflation. But I would look upon lower rates with mixed feelings if they promised more inflation and hence higher interest rates for the future." Those words are not mine, but those of a central bank colleague in Europe.[1] It seems to me they capture the essence of our policy problem.

Of course, as I suggested earlier, there is impatience for results. Monetary restraint is painful, and it cuts unevenly, at home as well as abroad. Moreover, the

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[1] Remarks by Karl Otto Pohl, President of the Deutsche Bundesbank, June 12, 1981, before the Roundtable of the International Banking Institute in Cannes.

burdens are not restricted to the industrial economies; developing countries are affected as well. Some are experiencing slower growth in their exports because of slack demand in the industrial world. They are all facing much stiffer borrowing terms in international markets than those to which they have been accustomed. It may be of little comfort to suggest that, in some cases, those terms may well have been too easy in the past—internationally as well as domestically nominal interest rates have frequently been exceeded by actual inflation rates, encouraging excessive indebtedness and the postponement of needed adjustments. What we would all like to see is a reasonable middle ground, and more stability and predictability; we will not succeed unless we keep at it.

If we cannot promise instantaneous and easy results—the answers do not lie in "fine tuning" fiscal or monetary policies—we can and must make the effort necessary to explain our policies, formally and informally, in all the forums available to us, and to consider carefully the views of others. In that connection, I have long felt that the economic summits can help assure that our mutual economic concerns are fully discussed and addressed at the highest level, and the success of those meetings over time can be measured less by any concrete agreements than by the degree of understanding reached about our mutual problems and purposes.

Certainly we must all avoid the temptation to become inward looking during this difficult period. Intensification of trade restrictions would be damaging to the interest of all countries. Together we must seek effective ways to help developing countries cope with their own serious adjustment problems, not the least by maintaining and strengthening our commitment to cooperation and dialogue in the IMF and World Bank.

Most of all, it is crucial that we not fail in our basic purpose of restoring stability and laying the base for sustained growth. One wise foreign official, widely experienced in international affairs, recently put it to me roughly as follows: You cannot expect us to be enthusiastic about the effects of your policies; we will all have different opinions about just how you are going about it; but the fact is we have no agreed better alternatives to offer you. We can only wish you success.

I would only add that with success the present international concerns will fade in memory. We would do no one a service, at home or abroad, it we were to take actions that would jeopardize the prospects for that success.

Representative REUSS. Thank you very much, Chairman Volcker. I think we all share the hope of these foreign gentlemen that high interest rates, too, will pass and that if we were to take idiotic actions to bring them down, it would not be good for anybody. That is why you and I have stood steadfast against those who would take such actions.

I ask that you take a look at the little newspaper piece of a few days ago, in which I took up the alternative that some—namely, in order to bring interest rates down—propose: What about creating a supply of new money at a fast pace? The trouble in doing that is that failure to control the money supply soon results in more inflation and even higher interest rates. You would agree?

Mr. VOLCKER. I do. I tried to make that point repeatedly. Again, among the foreign officials that I am most closely in contact with, I think there is widespread appreciation of that point.

Representative REUSS. So all of these officials agree in conversation with you and me and everyone else. The point, however, in getting the present murderously high interest rate down is that interest rate structure, as you can see by that chart [indicating], has no basis at all in relationship to inflation. It is more than 6 percentage points over the current inflationary rate.

I believe there are certain things that could be done to get that rate down; not by the Fed, necessarily, but by the Government. Since you are part of the Government and we are part of the Government, and since the net of our results is causing anguish at home and abroad, things that could be done will be the topic of our conversations this morning.

You refer to various European financial people. Isn't it true that the "Great Eminance" of them all, Gunther Schleiminger of the Bank for International Settlements, has said repeatedly that getting control of the budget deficit in this country is essential, and that unless we do it, you can have perfect monetary policy but the Treasury borrowing caused by large and continuing budget deficits will not help whatever good intentions the Settlement Bank might have. Isn't that what he says? Do you disagree?

Mr. VOLCKER. This a a general feeling that I share. The more we can do to get the budget in shape, the less the burden will be in financial markets and on monetary policy.

Let's be very clear. When they and we talk about reducing the burden on monetary policy and interest rates, they do not mean that we should pump up the money supply or credit. What they are saying is that within the framework of that policy of restraint on money and credit—which is essential—that with smaller deficits, with a restrained budget, the consequences on interest rates and credit markets will be less adverse.

Representative REUSS. Exactly. You agree with that, don't you?

Mr. VOLCKER. Yes.

Representative REUSS. Let met put to you what I think is an important question. Suppose President Reagan comes back from Ottawa "born again," so to speak; and suppose he says: "I have learned more about economics from Chancellor Schmidt and President Mitterand and some of the others than I ever learned in my life, and I learned this lesson that Volcker was talking about in the Joint Economics Committee last Thursday that budget deficits are indeed the 'devil and the flesh' of high interest rates and accordingly, I am—to the relief of many people at home and abroad—withdrawing my proposed tax program and am, instead, substituting one that will, generally speaking, make Americans whole against the increase in the payroll tax they are now receiving. I won't try to cut taxes so deeply that all I do is create deficits for the next 2, 3, or 4 years. Let's go with a much smaller and more carefully calibrated tax cut; let's help business by the lower interst rates that will ensue from such a controlled tax cut and let's help everybody else, including business, by getting inflation down, which will certainly ensue from lower interest rates."

If the President should say that and you were asked about it, would you be sympathetic to his utterance?

Mr. VOLCKER. I cannot speak for President Reagan, obviously, but I am sure he wouldn't want to be put in the position of having an uncontrolled tax cut that is adding to deficits. I think he is concerned about the deficits, too, and visualizes his tax program as consistent with reducing the deficits.

Representative REUSS. I am sure he does, but there are many people who think that, as a matter of simple commonsense, it won't work. Among those people are the heads of state who he will be with at Ottawa. Suppose, since he is a charming and outgoing man, he profits by this weekend. I ask you to put your mind on this assumption. Suppose he does say——

Mr. VOLCKER. To speak in the realm of the practical world in which we all live, I think this is a congressional problem as well as an administration problem. My concern about the tax program now

is that I have an uneasy feeling that, as the program winds its way through the Congress, following the new and somewhat reduced proposals made by the administration a few months ago, that things are being added to it——

Representative REUSS. I do, too.

Mr. VOLCKER [continuing]. In that process. I would hope the Congress could resist aggravating the situation; I would hope you would not add everybody's pet proposal to what, in its recent version, is a tax package that, in general, tends to offset the impact of inflationary "creep" on the tax structure.

Representative REUSS. Your hope is my hope. After all, the man who first gave the "whiskey to the natives" was President Reagan and if he would withdraw it, it might stop this rush you speak of, and which I agree with you is now going on. So what would you say if he made the kind of reversal which President Nixon made in 1971 and which every President sooner or later makes? Suppose that happened next Monday? Would that be good or bad?

Mr. VOLCKER. I have no sense that he will do that. I don't think it is useful to speculate in that particular vein. There are objectives that he is seeking through tax reductions that are completely legitimate and I am sure you feel very strongly about them. My continuing concern has been that the package not get out of proportion and that the relationship to expenditures be recognized. With the line held back on expenditures, I think we can have responsible tax reduction. It is not a question of all or nothing.

Representative REUSS. No one would disagree with that, but I think that your testimony would be on this question that fiscal policy does affect interest rates.

Mr. VOLCKER. Yes.

Representative REUSS. And that a monetary policy which is otherwise sound and sensible and anti-inflationary can be viciated by a fiscal policy which, whether by spending too much too soon on the military or cutting too much too soon on taxes, simply perpetuates the deficits which cause Treasury borrowing and the upping of interest rates.

Mr. VOLCKER. I think those are constant concerns that have to play a large role in the formulation of the "policy mix," as the jargon goes.

Representative REUSS. Let me turn now to another way which appeals to me as an interest rate lowerer without, in any way, impairing the Federal Reserve's close control over the money supply which you and I support. Right now, not only is the banking system of this country still grubstaking Bunker Hunt on silver speculations but many thousands of other speculators in every commodity known to man. The banking system has $20 billion at the ready; ready to grubstake the next round of mergers and conglomerate acquisitions.

Meanwhile, the farmer, the small businessman, the factory that wants to put in new plant and equipment, the homebuilder, the construction company, all are desperate for credit and are unable to pay the inordinately high interest rates which are caused by the speculative rain drawing up the whole interest rate structure to the outrageous heights to which it has been drawn.

Responsible bankers have recently testified before this committee that they would welcome the opportunity to agree between themselves—here we are talking about the Nation's biggest 100 banks, let's say—that in their lending policy, they will look with less favor on speculative loans to commodity speculators and purely financial takeover loans, and thus, with more favor on inflation-fighting, productivity-enhancing loans.

Most countries of the civilized world, in one form or another, do that. I know the difficulties. I know at the margin there may be a perfectly innocuous merger and a perfectly laudible commodity speculation, but we also know that it causes a great siphoning off of the Nation's credit and a higher structure of interest rates than is needed.

Wouldn't you welcome such a movement on the part of our patriotic bankers?

Mr. VOLCKER. Let me say, first of all—although it is hard to be certain about these things—that I do not sense a lot of speculative lending; the kind of speculation we had a year ago in the commodity markets.

Representative REUSS. We didn't sense that, either. We didn't sense what Bunker Hunt was up to, either. No criticism of you and certainly not me.

Mr. VOLCKER. There was a speculative flavor about commodity markets in the winter of 1979–80. It doesn't seem to be present at this time. On the contrary, commodity prices have been declining fairly steadily, as you know. I don't think we have that kind of atmosphere now.

We have had a burst of takeover loan commitments. I don't know as to how many takedowns yet, but certainly we have had a burst of commitments, which raise questions and concerns in a number of directions.

Representative REUSS. They are the corporate form of buying antiques.

Mr. VOLCKER. These may have a certain, not exactly speculative, but contagious mania about them at the moment. It is questionable whether this kind of loan on net extracts credit from markets because, of course, the money goes to the seller, who presumably puts it back in the market.

Representative REUSS. However, he may put it back in the market in Zambia, whereas we know that if a small businessman in Columbus, Ohio, or Brooklyn gets that loan to put in new machine tools, that will help our productivity.

Mr. VOLCKER. It is always hard to trace the money. Essentially, we rely upon the free market for sorting that out. As you suggested, this is an extremely difficult area in practice. There aren't any rules that I know of that don't contain enormous elements of arbitrariness and enormous enforcement problems—even if you wanted to enforce some rules.

Money is very fungible. It can be borrowed here or abroad, in different forms, from banks or others. I recognize what is going on recently in the takeover area raises questions of antitrust law, questions of how carefully some of these things are thought out, questions even of banking prudence, perhaps—just how carefully can these have been looked at from a credit standpoint when that

much money is put together that quickly? But I don't know of any simple answer. The presumption is that the market will sort these things out.

Representative REUSS. But if the market isn't sorting and produces the horrible results that it is now producing, would you resist the attempt of bankers to do the right thing? After all, bankers are in the business of varying their loan policy depending on the nature of the loan. If they got together and decided to do that which was good for the country instead of their own individual short-term interests, what is wrong with that?

Mr. VOLCKER. I don't think I can give you a conclusive answer; I haven't had a lot of bankers beseiging me with that request. I would not attribute, in any significant way at all, the kind of interest rate movement that you portray on that chart to this recent burst of takeover financing. In fact, though the figures are not good, our sense is that there has not been a large amount of takeover financing in recent bank lending figures.

Most of these very large numbers that you talk about and see reported in the paper—which are very large, indeed—at this point represent commitments. Indeed, many of those commitments are duplicative in the sense that they apparently reflect the fact that several companies are thinking of the same takeover; and they all can't buy the same company.

Representative REUSS. I would grant you this is prospective but you know the addage about shingling the house before it rains.

Mr. VOLCKER. I can understand questions being raised from a number of different angles, apart from the credit angle, about what gives rise to this burst at this time. I understand the concern about the credit angle.

Representative REUSS. I just want to wrap up this phase by asking this question: Suppose, to your surprise—and, I hope, delight—the bankers do come in and say: "Look, we want to be part of the solution; not just part of the problem with inflation in America. We would like, on a basis that protects us all under the antitrust exemptions, to embark upon a program of emphasizing anti-inflationary loans and deemphasizing pro-inflationary loans." Would you extend to them the right hand of fellowship or drive them from your door?

Mr. VOLCKER. I would certainly not drive them out the door. We would sit down and discuss what they have in mind and whether it made sense.

Representative REUSS. That's great.

Congressman Wylie.

Representative WYLIE. Thank you very much, Mr. Chairman.

Mr. Volcker, it is a pleasure to see you here this morning. Will the Federal Reserve Board's policy reduce inflationary expectations and high interest rates?

Mr. VOLCKER. I certainly hope so.

Representative WYLIE. I had a feeling that might be your answer.

When do you see a break in interest rates?

Mr. VOLCKER. I don't project interest rates, as you know, Congressman Wylie. I have found that a wise course for a number of reasons. Interest rates in the short run, consistent with the kind of persistent restraint we think is necessary to monetary growth, are

most immediately affected by what is happening in the economy generally. In other words, what demands for credit are being generated? What demands for money are being generated out of economic activity? Over time, certainly, the inflation rate and inflationary expectations are very important. It is hard to trace a direct relationship, partly because it is very hard to assess what inflationary expectations are with any precision at any particular time. Expectations are certainly an influence over time, but I don't think I can sit here and say that at any particular time inflationary expectations will change in a predictable manner which, by itself, will produce a predictable change in interest rates. That will happen, but as to just when it will happen and how it will happen, we will have to wait and see. It is certainly not going to happen unless there is confidence in the market—and not just in the financial market, but by the borrowers and lenders ultimately—that public policies are consistently directed against inflation and will be successful.

Representative WYLIE. I don't want to dwell on this but this is a question that I received over the weekend when I was in the presence of a group of financial people. The question was: How long will it take the prime rate to fall below 10 percent?

Mr. VOLCKER. I don't know.

Representative WYLIE. That's what I said. I don't know how you can predict that. Do you expect that it might in the relatively short term?

Mr. VOLCKER. The prime rate is now around 20 percent. Ten percent is a big decline. If you mean by "short term" a matter of a few months, that would be unlikely.

Representative WYLIE. Long term?

Mr. VOLCKER. In the long term, if we are successful in dealing with inflation—as we must be—certainly, in a historical context, a 10-percent prime rate is high. It is not now consistent with price stability over time. We have to get it down because it is not consistent with decided and continued progress towards price stability. Yes, we will get there, but I won't put a precise date on it.

Representative WYLIE. I can understand that. I just thought maybe I might be the beneficiary of a little expert information here this morning. From past appearances, I rather anticipated what your answer might be and it is not totally unexpected. I can certainly understand your position in that regard.

In your prepared statement, you note our weight in the world economy. Do you have any notion as to what the U.S. share of free world GNP might be?

Mr. VOLCKER. The figure that comes to mind is 25 percent. In the immediate postwar period, just to put in this perspective, it used to be 40 percent or more. It has declined a lot in relative terms. Of course, we are still by far the biggest economic power.

Representative WYLIE. Again referring to your prepared statement, you note that most governments are grappling with fiscal problems. Can you provide for the record figures on the ratio of Federal deficits to GNP in the United States and abroad?

Mr. VOLCKER. This depends upon the ability to make these measures of fiscal deficits more or less comparable, but just to give you some flavor, here are some 1979 figures of deficits as a percentage

of gross domestic product: In Canada, the ratio is 3.8 percent; in France, it is relatively small, 1.2 percent; in Germany, 2.9 percent; in Italy, over 11 percent; in Japan, 6.6 percent; in the United Kingdom, 2.2 percent; in the United States 0.6 percent; and in Sweden, a little over 7 percent.

Representative WYLIE. So our industrial allies are a little worse off than we are in that respect.

Mr. VOLCKER. They are. They are very aware of that and sensitive to the fact that they have larger deficits, by and large, by a considerable multiple than we do. They also have, just to put this in perspective, considerably higher savings rates, by and large. We have a smaller deficit, but it is impacting on a record-low savings rate of only about 5 percent, while the typical savings abroad is twice that or more in a number of countries.

Also the 0.6 percent figure for the United States is unusually low relative to other years. In 1981, it was about 2 to 2½ percent.

Representative WYLIE. So you would have 2 percent?

Mr. VOLCKER. It seems it should be more like 2 or 2½ percent, which is still well below the average.

Representative WYLIE. Is that the figure we want to use for the record?

Mr. VOLCKER. I would think so, yes.

Representative WYLIE. Congressman Reuss and I are going down to a Gold Commission meeting here very shortly at 10 a.m. Some responsible economists and businessmen are advocating a return to the gold standard, or a modified gold standard, a gold standard in some form. As a member of the Gold Commission, I would like to ask your opinion. Are those prospects feasible? Would they contribute to worldwide monetary stability?

Mr. VOLCKER. Perhaps I should not be prejudging the report of the Gold Commission at this point but, to put it mildly, I have had doubts, about the feasibility of returning to anything like an historical gold standard in any period of time than I can encompass at this point.

I think that those concerns do reflect the feeling that some kind of discipline is necessary. I sympathize with that thought and recognize the necessity for firm discipline in economic policy and on the economy so that inflation does not persist and we do not have recurrent episodes of inflation.

One can recognize the source of concern of gold standard advocates but, as a practical matter, there are enormous problems to that.

Representative WYLIE. Well, we will hear from some other witnesses. I wasn't attempting to get to what we should say in our final report yet. There will be a variety of different opinions, I am sure, as we go through our deliberations.

I have no further questions at this time.

Representative. REUSS. Thank you.

Congressman Richmond.

Representative RICHMOND. Thank you, Mr. Chairman.

Good morning, Mr. Volcker. I have some questions of you. First, do you have any personal opinion as to why the Japanese interest rate should be roughly 50 percent that of all of its other Western trading partners?

Mr. VOLCKER. Yes. They had a remarkably good economic performance and have managed to combine a better growth record than virtually all the other countries on that list with a return to price stability. I say price stability; their consumer prices are going up some; their wholesale prices today are slightly below what they were a year ago. They have a high rate of productivity in industry, not as high as it was 10 years ago but still exceptionally high by international standards. They have had restrained wage increases, good increases in real income in the context, as I say, of a rapid return to price stability from the problems they had a year or 2 ago.

Representative RICHMOND. You say a lot of this is due to government controls or just free enterprise?

Mr. VOLCKER. Not government controls in the strict sense. They have traditions—social ethic, if you will—that seem to contribute to good economic performance; among other things, they have wage restraint.

Representative RICHMOND. Wage restraint, of course, I believe that the head of the Japanese Government is involved with labor and management.

Mr. VOLCKER. He is certainly involved to some extent; the way the process works, in practice, is necessarily, I suppose, a little mysterious as far as what weight to attribute to what factors—industrial relationships within industry, union attitudes, governmental attitudes, the social conditions that characterize Japan, high productivity, rapid real income growth—all these meld together into good economic performance.

Representative RICHMOND. Is it amazing they are able to continue with an interest rate 50 percent below the——

Mr. VOLCKER. I think it is interesting that in the past 6 months or so Japanese interest rates have come down while ours, of course, have been high and other countries have been going up. The yen has depreciated some against the dollar but it was relatively strong against other currencies, an illustration of the fact that many factors enter into the exchange rate determination in addition to relative interest rates.

Representative RICHMOND. There is a note that says it has depreciated about 5 percent in the last few months against the dollar.

Mr. VOLCKER. Yes; by more than that if you take a longer time perspective. It depreciated less against the dollar than did European currencies. On a weighted basis, I believe their exchange rate actually appreciated some against all currencies.

Representative RICHMOND. Turning not to savings incentives, what do you think of the savings incentives incorporated in the Democratic and Republican tax bills? We realize we have to do something to help the savings banks and S. & L.'s in the United States.

Mr. VOLCKER. I frankly don't consider the savings bill a savings incentive. I cannot believe that bill will, in any significant way, increase savings.

Representative RICHMOND. What would you do to help out the savings and loan associations?

Mr. VOLCKER. We have had informal discussions with the banking committees about the so-called regulations bill. I would certain-

ly implement that as a matter of first priority. Whether that is adequate or sufficient, or whether something else would be necessary here, time will tell, but I would take that as the first step.

Representative RICHMOND. I think we agree the condition of our savings banks and S. & L.'s is critical right now. There is no way we can have homebuilding until we put the savings banks and S. & L.'s back into shape.

Mr. VOLCKER. Recognition of the condition of that industry is why the bill was proposed. I do not consider the "All Savers" bill an effective way to increase savings. It is a disguised method, I suppose, of helping the thrift industry. I don't consider it very efficient for that purpose.

Representative RICHMOND. You don't think the $1,000 tax exemption would immediately increase savings accounts?

Mr. VOLCKER. It would lead to a lot of shifting of savings among particular forms.

Representative RICHMOND. Back into savings accounts.

Mr. VOLCKER. There would be some of that. Most of all, the bill would lead, I suspect, to shifting of existing deposits among the wealthier people into another form, where it would be less costly to the institution and more costly to the Treasury.

Representative RICHMOND. Except that once you shift money out of a 90-day money market into a semipermanent savings account on which you get a $2,000 tax exemption, at least the bank knows they can give a long-term mortgage against that money, which they can't do with the money market money. I don't see how helping a bank to deal in money markets will help give out long-term mortgages. We have to devise something that will allow people to go back to savings accounts.

Mr. VOLCKER. Before they can make any substantial volume of mortgages and return to that market in volume, they will have to get net savings inflows in some volume. Their savings inflows have been continuing on the positive side by relatively narrow margins. The question is, How much shifting will you get within an institution and how much new money? You presume we will get some new money coming in, but in how big a volume? As I said, I don't think it is an efficient way to help that industry.

Representative RICHMOND. To change the subject, the current situation in Poland seems to be—the Government, the financial instability. Do you have any opinion on that as to whether we should be contributing more money to stabilize their economy or whether it is a lost cause? How do you feel about the whole financial situation in Poland?

Mr. VOLCKER. The financial situation in Poland is obviously precarious. They have run out of money. The situation internally is very difficult. I don't think it is in my province to pronounce Government policy on when and to what degree and how much aid to Poland might be helpful. There has been some aid to Poland, as you know, by us and by other countries. There has been rescheduling of their debts. I don't feel in a position to suggest at what point and under what conditions further assistance might be desirable.

Representative RICHMOND. Last, as a fellow businessman, let me ask a question: It boggles my mind that American business can continue to operate with 20-percent interest rates when the aver-

age American corporation only earns 5 percent after taxes and 10 percent before taxes. How can they afford to pay 20 percent? Why does American business still seem to be loping along? How come we haven't had an enormous upheaval of inventory drops? Inventories actually increased in May, much to my amazement.

Mr. VOLCKER. One is not disappointed, in one sense, in seeing the economy remain reasonably strong, but why does it remain this strong with that high interest rate? I am afraid part of the answer—not the full answer, but part of the answer—is that, given the past record on inflation and the expectations of businessmen and others, they are still willing to borrow at these interest rates because, in real terms, they do not appear as high as you might think.

One factor in that calculation undoubtedly is the way we treat interest in the tax structure. We talk about 20-percent interest rate. It is——

Representative RICHMOND. Ten percent after taxes.

Mr. VOLCKER. After taxes, for some people it is only 10 percent, and if you are anticipating a 10-percent inflation rate, that doesn't appear so high. I think that is a factor with a great many people, an increasingly important factor. The higher the inflation rate, the more important that factor becomes.

If you take the interest deduction at an effective rate, say, of 50 percent for some people, that means the interest rate has been cut in half; when the rate is 20 percent, you have cut it back to something near the inflation rate.

If you have price stability, let's say, and a much lower nominal interest rate of 3 or 4 percent, and you cut that in half, you will still have a positive interest rate. Here, at the extreme, you don't have a positive interest rate after taxes. This cuts very unevenly, depending upon the tax situation you are in. These distortions are inherent with a high rate of inflation given our particular tax structure.

Representative RICHMOND. Thank you.

Representative REUSS. At this time, I would introduce, without objection, an opening statement prepared by our colleague, Congressman Rousselot, and then I will recognize Congressman Brown.

[The opening statement of Hon. John H. Rousselot follows:]

OPENING STATEMENT OF REPRESENTATIVE ROUSSELOT

Mr. Chairman, today's hearing presents an opportunity to candidly discuss the Federal Reserve's role in promoting stable prices, and the implications of the Federal Reserves control of the monetary aggregates for consumers, bankers and investors. It is a pleasure to welcome Federal Reserve Chairman Paul Volcker. Hopefully this hearing will be a useful forum in discussing the Fed's role in providing a stable, non-inflationary monetary base, and indicate the Fed's support for the dollar before the Ottawa Conference convenes.

An as independent agency, the Fed is theoretically free from short-term political pressures for expansionist monetary policy. The Federal Reserve can hopefully expand the money supply enough to accommodate real economic growth without expanding the money supply at inflationary levels.

Since the November election, the Federal Reserve's laudable contraction of MIA, the current fiscal year rescissions, and rhetoric have been the only economic tools used in the Program for Economic Recovery. The fiscal year 1982 budget will not go into effect until October 1, and taxable income is being withheld in expectation of past tax rates. Yet the rate of inflation has fallen dramatically; for the past 4 months, inflation has been under an annual rate of 10 percent. In 1979, inflation averaged 13.3 percent, and in 1980 all items increased in price by 12.4 percent.

Much of the present success for consumers, long range planners, and investors has been attributable to the present contractionist monetary policy.

Lowering inflation has raised the real rate of return for savings and investment. Productive, job-producing investments of all natures, stocks, bonds, and financial institution deposits are worth more when inflation is reduced. Further monetary restraint is required to lower inflation to an acceptable level, and attract additional private capital for the reindustrialization of the Nation.

With lower inflation, U.S. citizens as well as foreigners will be more willing to hold dollars. Interest rates will fall if Congress can reduce the rate of growth of public expenditures, and keep the Federal Government out of the private credit market. It is my hope that the Federal Reserve will further restrain the monetary base to further stabilize prices and encourage capital formation.

Representative REUSS. Congressman Brown.

Representative BROWN. Thank you, Mr. Chairman.

Mr. Volcker, in our 1981 annual report, issued earlier this year, the Joint Economic Committee Republicans made the case that the increase in the money supply was followed 18, 20, to 24 months later by an increase in the inflation rate. In other words now the rate of growth in money supply increased and the inflation rate increased sometime later. Do you think that is a valid kind of tracking of what has happened to the inflation rate and interest rate and money supply relationship?

Mr. VOLCKER. I certainly agree that there is a broad relationship between growth in money supply and inflation. That is the basis of our policy. I think it is difficult to relate it quite as precisely as some of these analyses suggest. I am familiar with the charts and equations that have been developed, and I accept the broad relationship; but none of these relationships is mechanically precise.

Representative BROWN. Some of my friends in the Congress and elsewhere, who call themselves economists—whereas, I don't call myself an economist—suggest that if we accelerate the growth of the money supply right now, we would reduce interest rates. Is that true in the short term or the long term?

Mr. VOLCKER. It is certainly not true in the long term. I would urge this point upon you: To the extent we increase the money supply, and that has some inflationary repercussions, we would increase interest rates over time. What happens in the short run depends upon how expectations are affected.

Historically, I think one could suggest that increasing the money supply might reduce interest rates in the short run, but, as expectations about the longer term effects become more sensitive, one cannot even be sure of the short-run impact. You might even be disappointed to see a decline in interest rates in the short run, given the current state of expectations.

Representative BROWN. Like a cheap drunk. You might not feel that much better in the short run but would feel a lot worse in the long run.

Mr. VOLCKER. No question about that.

Representative BROWN. Let me throw a question at you about the current situation. If the President's budget reconciliation package—reductions in Federal spending and changes in the laws that make that possible—is put into effect but there is no tax bill, is the impact going to be beneficial if one can assume that it does reduce what might otherwise have been the rate of Federal borrowing?

Mr. VOLCKER. If you make that assumption, I think it would have some favorable impact on the financial market. That is not

quite the same as saying that it would have that result from a total economic policy perspective. That's where the argument comes in on the importance of incentives, the importance of reducing the burden of taxation over time. Encouraging expenditures restraint in the future, I think, raises valid issues that have to be considered.

Representative BROWN. If you could maintain that Federal expenditure restraint so that you take the Federal Government out of the market for borrowing money to some extent, to that extent, don't you improve the inflation and interest rate expectation situation?

Mr. VOLCKER. You relieve the pressures on the financial markets, I think, thereby improving the climate in the financial markets and having a more favorable interest-rate picture.

You ask whether you would improve the inflationary situation. That depends. Let's say you forgo business tax reductions, depreciation reforms, and so on. You would have to consider whether you are, on balance, hurting the process of business investment, which might have a favorable impact on inflation over time.

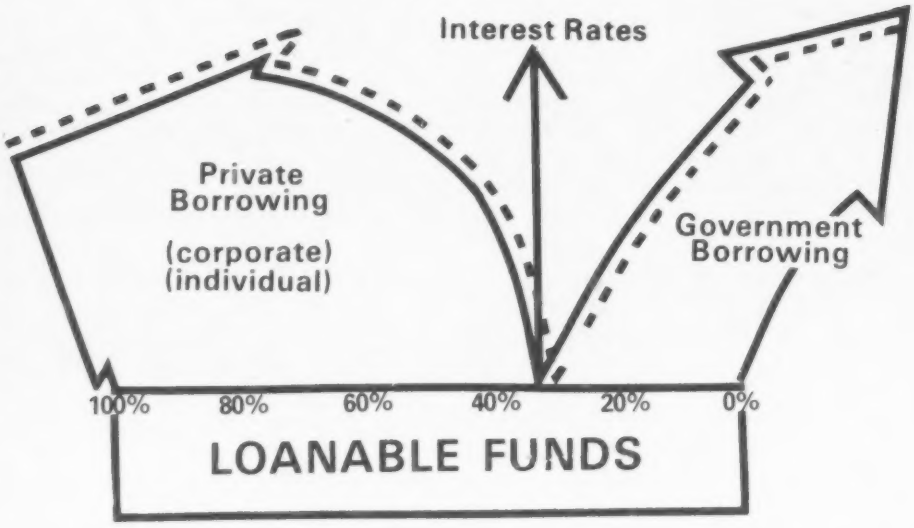
I don't think the long-term effects on inflation would be exactly the same, necessarily; they may be the opposite to the immediate impact on the financial market. That's why these questions are not simple to isolate from the total of economic policy.

Representative BROWN. As a visual of what the administration program is trying to do, I see it this way [indicating to charts I and II]: There is a certain percentage of loanable funds in the market. The ambition is to reduce Government borrowing to some extent so you take the Government out of the business of competing for these loanable funds and that opens up for the business community the opportunity to borrow funds.

If those two things are in balance, there is no impact on the interest rate or the rate of inflation presumably because the private community can borrow and expand on the basis of the public community's reduction of its borrowing and this allows for business expansion, modernization, and the sort of positive things we want the business community to do.

[Chart I follows:]

CHART I, July 16, 1981, Hearing



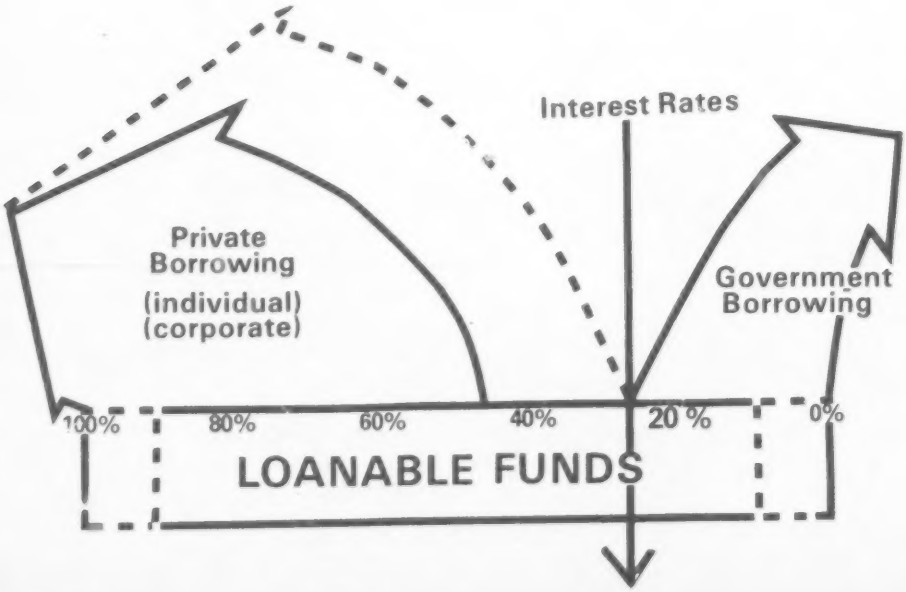
Mr. VOLCKER. That would be consistent with lower interest rates. The thing that would encourage private borrowing would be a reduction in pressure on financial borrowings, which would encourage private borrowing for productive purposes.

Representative BROWN. Now phase two, the second part of the program, is a tax bill that would stimulate private savings. The purpose of the savings would be to enlarge the base of loanable funds, right?

Mr. VOLCKER. Right.

[Chart II follows:]

CHART II, July 16, 1981, Hearing



Representative BROWN. So the reduction in Government borrowing would allow a great deal more private business expansion with the same interest rates. If you don't quite get all that private business expansion borrowing or more sharply reduce the Government borrowing, the impact is to bring the interest rate down.

Mr. VOLCKER. Other things being equal, if you increase the savings rate, the interest rate will come down and you will presumably get more private borrowing.

Representative BROWN. That ought to be our objective.

Mr. VOLCKER. Yes. If we can manage that, I think it would be very helpful.

Representative BROWN. Therefore, one of the basic parts of this is that one of the impacts of increasing savings is whether the impact of the tax system is to increase private savings. Now you indicated that the ratio of deficit to GNP in the United States is not all that bad compared to some of our major trading partners or other industrial nations.

Mr. VOLCKER. Very low.

Representative BROWN. So the impact really is a question of savings, is it not?

Mr. VOLCKER. You have to look at savings and the deficit. Let me give you figures to put it in perspective.

As to personal savings: We generate in this country about $100 billion of personal savings a year. Using budgetary figures for this calendar year, we have a deficit of roughly $60 billion—hopefully, somewhat less than that. Add $20 or so billion to that for directly financed credit programs, and you get some $80 billion—more than three-quarters of the amount of personal savings.

I put those figures in juxtaposition to suggest a sense of proportion. If we increase the savings rate, we are doing a constructive job, as you suggest in your chart, but it is also important to reduce that Government deficit, which takes such a large chunk of the savings. Ideally, you have to do both, but we have found it hard to get that savings rate increased.

Representative BROWN. If you reduce the tax on the income from savings and investment—reduce it or remove it—to the extent you reduce it, you do stimulate the savings patterns of people; is that correct?

Mr. VOLCKER. Yes.

Representative BROWN. And the large savings in terms of the total dollars come at the high-income level, so the 50- to 70-percent drop will create the most savings.

Mr. VOLCKER. Yes. I think that particular decrease in tax will not give up much Government revenue; therefore, it should not have much impact on the deficit.

Representative BROWN. Now I come to the psychological point. Wouldn't it also be very desirable to stimulate the savings pattern of the average American, who is counting on social security for retirement, counting on inflation always going up at a rather sharp rate. If we could convince the average American, by cutting his tax impact on savings to be an increased saver—according to the Internal Revenue returns, we find that people with incomes even down to $6,000 adjusted gross income are savers—it may not be a sensible thing for them to do from the standpoint of return on their

money but they still are savers, and if we could convince them there is an advantage in savings and also that inflation is not going to continue to leap up all the time and that, by saving, they have an advantage—don't you then tend to break the psychological side of the inflation argument?

Mr. VOLCKER. I don't know whether you would break the psychological tide of inflation. You are presuming—and I would strongly agree with you—that part of this process must be a sense of progress on inflation so we think it is worth while to save.

Representative BROWN. Or a tax cut on savings so it is worth while to save.

Mr. VOLCKER. When you get into a tax cut on savings, you have got basically an empirical question. How much will that stimulate savings and at what expense of Government dis-savings? If you lose more on the deficit than you gain on the savings, in terms of the overall kind of analysis you are suggesting, you are not ahead of the game. If you can develop some practical way to stimulate the savings without creating a bigger expense in terms of the budget deficit than you are gaining in terms of savings, then you are ahead of the game.

Representative BROWN. The point I was trying to get to was that you cannot just cut taxes for the big savers, but also for the small savers, who may not give you much money, but if you ignore the small saver in the tax cut, you do not address inflation from the psychological standpoint. Many Americans buy next year's Christmas presents this year because they think next year the price of the items will be higher.

Mr. VOLCKER. I think it is terribly important to emphasize the point you are making. A major influence on savings, and on "buy now" or "buy later" psychology, is what people think about inflation, so I think any of the programs that you are talking about, any measures that might be considered, have to be worked into the context of an overall program that, in fact, promises to reduce inflation.

Representative BROWN. And if they save and have something for their future, it might take the pressure off social security. If we get to the point where we have to vastly increase the borrowable capital, that makes the modernization come every year because the interest rate would still be low and modernization is going on, then we do intend to reduce inflation and have the industrial boom at the same time that we would like to have.

Mr. VOLCKER. The low-savings rate in the United States is a central part of our problem.

Representative BROWN. Something just to bail out the savings and loans, therefore, is not necessarily our objective, though that's a worthy objective.

Mr. VOLCKER. The thrift institution problem is certainly real. My objection to the "all savers" bill is that I don't think it will be effective in increasing savings.

Representative BROWN. Thank you very much. I have overrun my time. I appreciate the courtesy of the chairman.

Representative RICHMOND [presiding]. Thank you.

Recently, the administration took an action which will jeopardize the reauthorization or appropriation of a number of international

financial institutions like IDA, IDB, World Bank, perhaps, and IMF. As you know, the step was the administration's decision to reverse a standing policy in human rights and vote in favor of loans to Chile, Argentina, Paraguay, and Uruguay, even though those countries are guilty of some of the more deplorable actions in the field of human rights.

I wonder whether this effect will turn off a lot of liberal legislators on administration policies and will probably hold up the refunding of a number of these agencies. How do you feel about the administration's policy in this, knowing full well that the law in the Harkins' amendment is quite clear that we cannot condone loans or the use of American money in countries where they don't practice a reasonable level of human rights?

Mr. VOLCKER. I won't comment on what is essentially a political issue. I would hope that this kind of issue does not result in any disposition not to fund those institutions. I think American participation in those institutions, where the human rights issue is resolved, is terribly important in the very direct sense of the important role of those institutions in financing economic development. I think that is important to the welfare of the United States in terms of maintaining and continuing American leadership and influence in those organizations and cooperating with other countries in economic development.

I think it would be extremely shortsighted to cut off American funding of those institutions or reduce it below the negotiated amounts because of the kind of controversy to which you refer, recognizing all the sensitivities of that conflict.

I think there are important continuing issues here of our relationships with those institutions and with the rest of the world that I would hope would impel the Congress to continue to support those institutions, however that particular issue is resolved.

Representative RICHMOND. Even though the administration is absolutely foregetting about the Harkins' amendment, which was passed by a very wide margin of Congress and under which we are supposed to be operating now? In other words, how can we expect the Congress to vote against itself basically when we set up the policy several years ago that any nation which is deplorably guilty of serious infractions of human rights should not receive American funds?

Mr. VOLCKER. I am just not competent to consider the legal ramifications. I haven't followed it closely. I cannot trace through the administration's actions, vis-a-vis the congressional intent of the law. I am just not that familiar with that issue.

But I do feel very strongly that there is much more at stake in our participation in these institutions than the questions that you raise, recognizing that those questions are extremely sensitive and important to many people. I think they have to be put in the total context of our participation in extremely worthwhile and critically important activity in terms of our role in the world.

Representative RICHMOND. Thank you for your opinion. My problem is that we are a nation that is supposed to live under the law. The law says American funds are not supposed to be used in countries guilty of human rights deprivation. I wonder what——

Mr. VOLCKER. As I recall it, the law—or the resolution—spoke as to what position the United States should take in those institutions. It is inherent that the decision is a collective one and we cannot expect, I think, to have our opinions prevail all the time over those loans.

Representative RICHMOND. Our representative in those institutions should certainly vote in accordance with the laws of Congress.

Mr. VOLCKER. That is a matter that I am just not familiar with in terms of recent votes, but I simply do urge upon you the importance of active American participation in the funding of those institutions.

Representative RICHMOND. Does your support of the regulation bill indicate you feel interest rates will stay high and that there will be some bank failures in the near future?

Mr. VOLCKER. I think it would be very imprudent to assume that interest rates are going to go to any particular level, including a much lower level, in time to avoid any problems in that industry. We already have problems.

Representative RICHMOND. Without wage and price controls, with a massive tax reduction, without bank controls, there is no earthly way interest rates can drop in the United states, and we have to assume they will be high and that you, as the Nation's lead banker, are faced with a major problem of keeping your banks alive.

Mr. VOLCKER. We have important problems, particularly in the area of the thrift industry, and I think it is the judgment of the regulators that they need some enhanced tools to help deal with those problems. That's why I would urge that legislation upon you.

Representative RICHMOND. If inflation continues, if interest rates remain high, will there ever become a time when you personally would indicate we ought to start restraining somewhat and use some of these tried and proven methods of reducing inflation and reducing bank interest by some type of wage and price controls, somewhat less income tax reductions, somewhat stronger bank regulations—a general income policy?

Mr. VOLCKER. I think the problem is that those approaches have been tried and have been particularly unsuccessful, to put it mildly. I think the key has to be financial discipline, fiscal discipline. The problem with those approaches in part—and they have lots of other difficulties—is that to the extent they are considered a substitute for these other disciplines, they are bound to fail. I think the history here and abroad is that those tend to be looked upon as a substitute for the other disciplines. To the extent they are looked upon as a substitute, they won't work, and we will just end up with a worse problem than we started with. I do not see the usefulness of that approach.

I do think that the success or failure of our anti-inflationary effort is going to be reflected importantly in the trend of wage bargaining and wage settlements in the coming year.

This is not a particularly active area in terms of large settlements coming up this year or in the next few months, but there are critical settlements coming up in a 1-year time perspective.

I think it is terribly important that there be an understanding of the relationship between those settlements and the speed and ease

with which inflation will recede. In approaching the bargaining table, those realities must be recognized and acted upon.

That doesn't suggest to me we can answer the question by controls or by an income policy or whatever. It does suggest to me that to the extent that public policy has in part shielded or would newly shield particular industries from competitive pressures, we are doing the country a disservice. Industries that are exposed to competitive pressures ought to come to realize that they can help deal with those competitive pressures in only one way—over a long period of time—by restraining on their own cost structure.

Representative RICHMOND. I wish it would happen. My feeling is, without some type of Government intervention, which we see in Germany and Japan and other countries that controlled their inflation, without some type of Government——

Mr. VOLCKER. What I am suggesting is that Government intervention may encourage high costs and excessive wages. The least we ought to do is to remove those Government impediments to the competitive process.

Representative RICHMOND. We know the reason for the stability of Japan along with high productivity is the fact that Government is very much a part of labor and management. That is somewhat the same situation in Germany. It certainly is in Austria. They have a wage price commission that pretty well controls Austria. They have the lowest rate of inflation in Europe.

Mr. VOLCKER. That is not my impression. I had the staff look into the Austrian situation a bit. They do not attribute great weight to the so-called incomes policy effectiveness in Austria.

Representative RICHMOND. The director of that policy was here before our committee and explained it chapter and verse, and indicated that is why Austria had the best record of any country in western Europe.

Mr. VOLCKER. Opinions may differ. I know the conclusion that my staff reached is that the most important factor was, effectively, the commitment by Austria to maintain exchange rate stability with some of their partners, which knowingly kept their industry under strong competitive pressure. It was that kind of knowledge of potential and actual competitive pressures in an open economy, in a rather small economy that has to compete abroad, that produced the incentive to keep wages and costs in line.

It has been quite successful, but my staff attributes the primary importance to this Government commitment to maintaining an openness of competition and strong competitive pressures by maintaining exchange rate stability.

Representative RICHMOND. Thank you.

Representative Brown.

Representative BROWN. I would like to pick up again on what makes the economy behave; motivational things. The statistics I have indicate that ratios of savings to disposal income from 1961 to 1963 in this country were roughly 6 percent. In 1964, after the so-called Kennedy tax cut in 1963, the savings rate went to 7 percent and then stayed at 8 percent in 1965, 1966, and 1967. Then in 1968 in June we passed the tax surcharge; higher taxes caused the savings rate to drop to 7 percent. Then in 1969 it dropped to 6 percent.

In 1970, we cut the surcharge in half; to be done in steps. As a result, the savings rate went to 8 percent in 1970 and 1971. Over the last few years, because of inflation pushing people into higher tax brackets, the average tax rate for individuals moved up and as they go into higher tax brackets and the savings rate drops sharply and continues to drop.

It seems to me that that is at least generalized evidence that what we do with taxes, higher or lower, has some impact on the savings rate of the individual. Would you tend to agree with that argument?

Mr. VOLCKER. I think it must have something to do with it. There are a lot of other factors impinging upon these fluctuations in savings rates. Indeed, the figures are not good enough to put too much weight on year-to-year changes in a figure computed as the difference between two uncertain figures. But I have no trouble with the proposition that there is some relationship.

Representative BROWN. In yesterday's Wall Street Journal, an article called "The Alternative Tax Bill Would Be a Mistake" points out the tax bill offered—I guess the Democratic alternative; I tried to say it in a graceful way that left it nonpartisan—at any rate, that tax bill proposal moves toward more taxes on higher incomes or less taxes on moderate and low incomes, and dilutes the general tax reduction altogether.

Gary Schilling, in that article, suggests that this continues 50 years of discouraging savings in this country. I don't know whether you had a chance to read that article or not.

Mr. VOLCKER. No, but——

Representative BROWN. It would seem to bear out that the proposition that as we tax more at the higher income levels—for instance, taxing less at the moderate and low income levels, we have an adverse effect on those people who are the largest savers and, therefore, have the greatest impact on the total saving done in this country. Is that a fair statement?

Mr. VOLCKER. In general, yes; higher income people tend to save more. If you are just looking at the savings impact, it is likely to be greater at those levels. If you extended that reasoning, I suppose you would expect the greatest impact on savings to come not from tax reductions on personal income but from business tax reductions because their savings rate is higher still.

Representative BROWN. We may not like high income people because we envy them or may not like business people because they make an awful lot of money and are extremely wealthy, but, on the other hand, they do provide the greatest amount of savings, don't they, for society and maybe that's a public service to us moderate income people or people who, if we weren't in politics, might have to work for a living [laughter] and, therefore, we affect the people that benefit from the creation of jobs. It seems to me that we have to look at that as a social impact on society.

If we encourage savings, we have done a social good for society.

Let me now switch around a little to ask you about money coming in from abroad and its impact on our economic circumstance, the social jobs benefit. I heard distinguished economist recently suggest that, because of the instability now created in French money markets by the election of Mr. Mitterand to the

control of the French Government and by the difficulties that Helmut Schmidt is having within his own party over politics and policies, that it might be likely over the next few months or years that there would be a flight of European capital to the United States, with Europeans investing here in businesses, investing in the dollar, and it might even be a flight of European corporate plant locations to the United States. Does that appear to be a logical conclusion out of political instability in Europe?

Mr. VOLCKER. Let me say that the statistics are not very good, but one has an impression that there has been an increased flow of money to the United States from various European countries for a year or more, possibly motivating in part by some feeling of political uncertainty—apart from the reasons you mentioned—such as the Polish situation, which was raised earlier.

I wouldn't want to call it a "flight," but there has been some movement of capital in this direction, and I expect you would expect the uncertainties to be a factor in maintaining that.

Representative BROWN. I have seen poles recently that say while the average American does not think he would be better off within a year, he has been encouraged in the last few months by whatever cause to feel that he will be better off in the long term. That, it seems to me, may also encourage the average American, the homeowner, somebody who wants to send his kids to college and so forth, to make the commitment to an investment because, in the long term, he thinks he will be better off and better able to cover it. It may not be fair to blame Ronald Reagan, therefore, for the pressures of increased borrowing that have occurred in the marketplace and the expansion philosophy of individuals and businesses, but one might say if you follow that logic that President Reagan is hoisted on his own pitard.

His election and the optimism that flowed from it in the business community may have increased the borrowing at a time when Federal borrowing is not under control and that increases pressures on the interest rate. I would go back to my chart if I though we could hold it up straight. [Laughter.]

That increased pressure on the interest rate, the only real way is to address that growing optimism in the country for future modernization and activity is to either cut Federal spending and, therefore, take the Government out or competition for those borrowable dollars, or to increase savings. We have taken the first step toward cutting Federal spending and now if we don't take the second step to encourage increased savings by a tax cut, we have missed the second part of our opportunity.

Mr. VOLCKER. I think you state the opportunity very well. The only question is the efficiency of the fiscal or tax action in increasing savings relative to the loss of revenue. That's a technical problem, but an important issue.

Representative BROWN. Could you describe this as a tax cut that might do that with the least revenue loss to the Government? Let me start with the one that you and I seem to agree would not increase the savings much and would have a large revenue loss, and that is the "all savers" proposal.

Mr. VOLCKER. Exactly. That's a way not to go, I suppose.

Representative BROWN. Are you familiar with the two-stack tax cut?

Mr. VOLCKER. Yes.

Representative BROWN. Would that be a desirable one?

Mr. VOLCKER. I find that intriguing. I just don't know enough about it to know what the revenue loss would be and how it could be phased in, but I do think that it goes to a kind of central problem of our tax structure, that is, that it taxes savings and investment at high marginal rates and discourages investment and savings. This two-stack approach, as I understand it, is one possible attach on that bias that is inherent in the present situation.

Representative BROWN. That's savings down to the lowest rate on the first dollar, or as they increase their savings, they can lay their deductions against those savings.

Mr. VOLCKER. I have not done an analysis, which is difficult at best, of how much revenue loss is involved and how great the potential savings are now or in the future.

I think it does move conceptually in the direction of repairing the bias in the tax structure.

Representative BROWN. What about a tax structure that would give everybody a larger cut in taxes the higher the percentage of their income they save?

Mr. VOLCKER. I haven't thought of that one. I hesitate to answer. It sounds nice when you say it, but I don't know what kind of practical problems that would create. At the extreme, you would go to a consumption tax, which has been proposed for a long time. You only tax consumption, and you tax it at progressive rates. If you save money, you don't get taxed at all. That goes all the way toward correcting the bias of which I spoke, but I simply better not get over my head in analyzing something——

Representative BROWN. So if you really want to help inflation and interest rates, we better address the taxes that we now have on income from savings and try to focus the legislation not on helping one individual segment of society but reducing the total tax on savings so that the average American, whatever his own income, will be encouraged to save and then let him make his determination whether he wants to put it in S. & L.'s, the layaway plan, an IRA account, or anything else.

Mr. VOLCKER. Always looking toward affecting the fellow at the margin in terms of his savings decision.

Let me just say there are worse ways of going about this than just cutting tax rates. In fact, when one looks at the special schemes, such as the "all savers" bill, reducing marginal tax rates looks better and better. It is a question of how much revenue you can afford to give up in the short run given the budgetary situation.

Representative BROWN. One final question. How much trouble are we in in this economy if we don't get the tax cut at all? When do we start getting into real trouble if we don't get a tax cut?

Mr. VOLCKER. We are in trouble in the economy mainly because of this inflationary momentum and all the behavior patterns that it has given rise to. These must be reversed; it is not an easy process. Amid this whole complex of problems that we have to solve, so many of which are rooted in inflationary behavior, I don't

want to set any time limit on tax reduction. I think tax reduction is constructive. It is constructive in reducing the inflation rate rather directly in the sense that taxes add directly or indirectly to cost.

What we are struggling with is the impact on the deficit for a period of time. That puts the burden back on the spending side.

Representative BROWN. Let me ask a question in a somewhat different way. A delay in a savings-inducing tax cut or a delay in the reconciliation/budget spending reduction, in either case, we are not well served, is that correct?

Mr. VOLCKER. You have to look at them in combination. We are best served by moving ahead in this respect as promptly as possible—by cutting the expenditures which make possible, in my view, the responsible tax reductions that are also urgently desirable. We have to look at both sides of the equation. The progress we can make on taxes would be affected by a lack of progress on the spending side.

Representative BROWN. And the delay does not serve us.

Mr. VOLCKER. Delay in the total package does not serve us at all.

Representative BROWN. I would suggest to the chairman he made a comment about the Congress voting against itself. I think the Congress better vote on these issues before the public decides to vote against the Congress and I encourage us to move as quickly as possible.

Representative RICHMOND. Thank you. All I can say is that Chairman Reuss and I disagree. We believe the best way to reduce inflation in the United States would be to balance the budget, not to have a deficit and not have a tax cut until the national budget is balanced. I think that would be the most deflationary thing Congress can do.

It is not popular. It won't happen. You also don't really feel that perhaps this tax cut is going to reduce inflation immediately. You are a banker. Would you agree to a major tax cut along with a $60 billion deficit?

Mr. VOLCKER. I would not like to see another $60 billion deficit.

Representative RICHMOND. You will have one.

Mr. VOLCKER. I hope not. I would just say that the importance of expenditure control is spotlighted by a tax cut. I don't think you can take one without the other. I do not think that size deficit would be constructive in terms of conditions in the capital and financial markets, so I think there are consequences of moving ahead with a tax cut that have to be recognized and I think are being recognized.

I am encouraged to see what is going on on the expenditure side in the sense of congressional action. I am also concerned that there is a great deal of momentum on the spending side of the budget which may have been underestimated. I don't know what else I can add.

I do not think it is a practical proposition to think we might not have a budget deficit next year. I would like to see that. If I could wave my hand and have no deficit next year, that would be devoutly to be wished, but it is not going to happen. You have got to make your decisions in the context of what will be most helpful in getting that deficit reduced over time; that has to be a major

element in your decisionmaking; that balance has to be maintained.

Representative RICHMOND. I would rather see a balanced budget and some selective tax cuts just to clean up the tax code, such as discrimination on the marriage penalty, that type of thing. I believe we are not ready for a major tax cut.

Mr. VOLCKER. If you could get a balanced budget next year, I would agree with you.

Representative RICHMOND. We will be close to it.

Thank you very much for coming this morning. As usual, you have been able to answer every question we threw at you.

The committee is adjourned.

[Whereupon, at 10:25 a.m., the committee adjourned, subject to call of the Chair.]

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